KHYBER PAKHTUNKHWA POST-BUDGET ASSESSMENT AND ROUNDTABLE REVIEW

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ACRONYMS

AoP	Association of Persons
BMR	Balancing, modernization, and replacement
BoIT	Board of Investment and Trade
BPC	Bulk Power Consumer
BSM	Border Sustenance Market
CGT	Capital Gains Tax
CPEC	China Pakistan Economic Corridor
DISCOs	Distribution Companies
E&T	Excise and Taxation
FBR	Federal Board of Revenue
GoKP	Government of KP
IT	Information Technology
KP	Khyber Pakhtunkhwa
KPEZDMC	KP Economic Zones Development and Management Company
KPRA	KP Revenue Authority
KPTGCL	Khyber Pakhtunkhwa Transmission and Grid System Company Limited
LTV	Loan-to-Value
NEPRA	National Electric Power Regulatory Authority
NMA	Newly Merged Areas
OECD	Organization for Economic Co-operation and Development
PEDO	Pakhtunkhwa Energy Development Organization
PESCO	Peshawar Electric Supply Company
POS	Point of Sale
PPD	Public-Private Dialogue
R&D	Research and Development
SBP	State Bank of Pakistan
SCCI	Sarhad Chamber of Commerce and Industry
SEED	Sustainable Energy and Economic Development
SEZ	Special Economic Zone
SIDB	Small Industries Development Board
SME	Small and Medium Enterprises
SMEDA	Small and Medium Enterprise Development Authority
T&D	Transmission and Distribution
TERF	Temporary Economic Relief Facility
UIPT	Urban Immovable Property Tax
WHT	Withholding Tax

PROGRAM **DESCRIPTION**

ABOUT SEED

Sustainable Energy and Economic Development (SEED) is a £15 million programme that aims to support provincial economic development and sustainable energy in Pakistan. It will support the province of Khyber Pakhtunkhwa (KP) to plan and finance the infrastructure and investment it needs for growth, jobs, and prosperity. The programme will also address Pakistan's energy crisis by providing innovative financial solutions to the industry for the adoption of sustainable energy practices. Within SEED, ASI has been contracted to deliver the first component - Improved Economic and Urban Planning in KP – with a budget of £15 million. The stated outcomes of the program continue to be public and private investments focusing on greater economic, social, and environmental returns. The program is managed by the British High Commission (BHC), Islamabad under the umbrella of the UK's Foreign Commonwealth and Development Office (FCDO).

KP BUSINESS VOICE

Strong Public-Private Dialogue (PPD) mechanisms can improve the transparency, effectiveness, and responsiveness of taxation, regulation, public investment, and other public policies. SEED will strengthen PPD between the KP business community and the government of KP by articulating private sector problems, soliciting policy proposals, and channeling them to relevant government policymakers through three mechanisms:

PRE-BUDGET FISCAL POLICY PROPOSALS AND POST-BUDGET ASSESSMENT FOR FY 2021: Pre and post-budget briefs will be prepared that would assess the federal and provincial budgets, study the implications of key fiscal measures for KP businesses, and in the case of pre-budget brief, propose a set of policy measures that would support KP businesses in different areas including fiscal interventions.

BUSINESS BAROMETER: Surveys will be conducted on a quarterly basis, designed to capture the perceptions and performance of KP businesses. The surveys will help stakeholders in gauging the investment and business climate within this region, which has different and diverse business dynamics, regional capabilities, and natural resources compared to the country.

SECTOR-SPECIFIC ROUNDTABLES AND POLICY BRIEFS: These events will gather representatives of KP government departments as well as corporate leaders from firms, business forums, and associations that are relevant to the particular sectors. These sectors may include agriculture and livestock, forestry, manufacturing, mines and minerals, transport, among others. The discussion will focus on key policy proposals raised by industrial representatives to improve firm-level output, jobs, productivity, and investment. Policy Briefs will be prepared and published, capturing the discussion held during each Roundtable. Around 3-4 roundtables will be held during the course of the assignment.

The Post-Budget roundtable held on July 28, 2021, hoped to allow KP businesses to articulate the impediments they faced, open and strengthen dialogue between the KP leadership and the business community, and create synergies to achieve long-term sustainable growth in the province. This brief report studies the federal and provincial budget from the perceptions of KP businesses and highlights important issues raised during the roundtable.

ROUNDTABLE DISCUSSIONS:
KP BUSINESS CHALLENGES AND GAPS

In contrast to its fast-growing population, KP's economy is amongst the slowest in Pakistan, its contribution to the national GDP maintaining at 9.2 percent between FY11 and FY18. Khyber Pakhtunkhwa's business environment is characterized by many of the challenges that businesses across Pakistan face but with the added complexities of political and geostrategic instabilities that have thwarted growth in the past.

Now with many of these unique challenges abating, KP has the opportunity to leverage its geostrategic importance, its natural resources, and unique capabilities to meet its growth potential. This can be done through the fiscal support of the provincial government, improved governance through reforms, and the province's coordination and collaboration with the federal government as well as significant economic, regulatory bodies such as the Securities and Exchange Commission of Pakistan (SECP) and State Bank of Pakistan (SBP).

Before assessing the federal and provincial budgets—and the reforms introduced by the KP government thus far—this section provides a quick review of the major factors that businesses feel are affecting their growth and productivity. This has been developed keeping in view the post-budget roundtable discussion held in July-21.

Broadly: poor tax administration, access to finance, challenges relating to the cost and access to energy, and overall ease of doing business were the key driving points of discussion during the roundtable.

TOP FACTORS AFFECTING BUSINESS PERFORMANCE IN KP

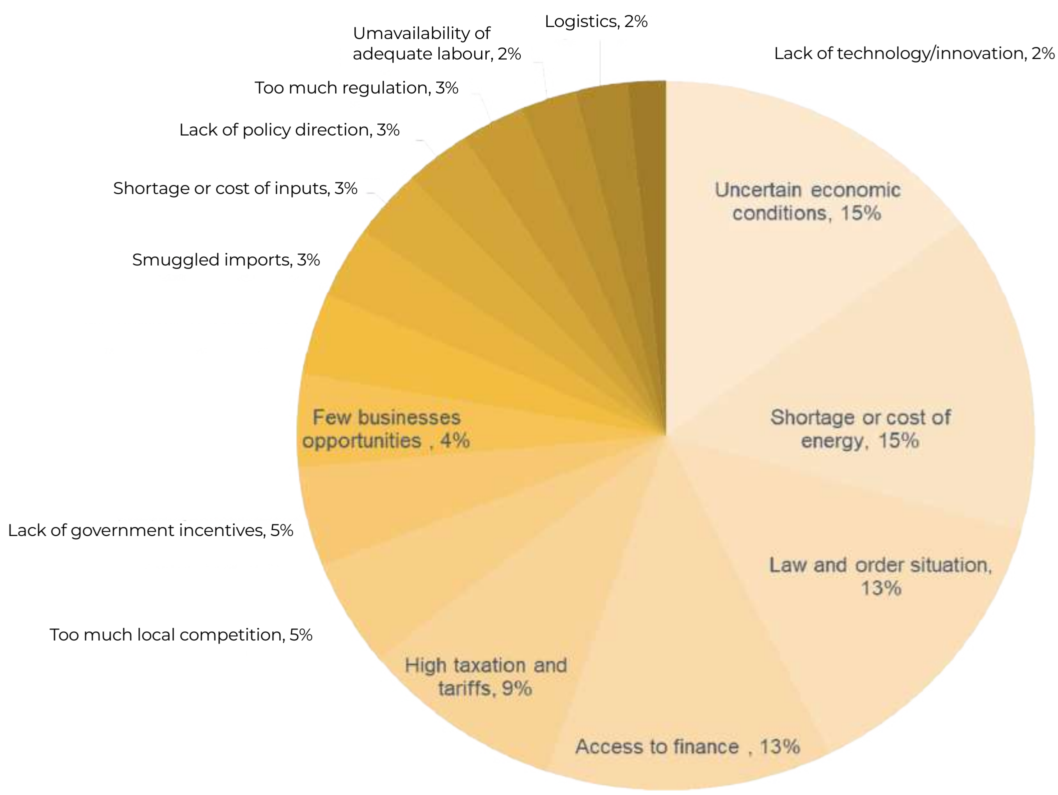


Exhibit 1: Factors Affecting Business Growth in KP

These coincide with and mirror the findings of the first KP business perceptions survey conducted under the KP Business Voice intervention of SEED. Uncertain economic conditions, shortage/cost of energy (tying at the top spot), law and order situation, access to finance, and high taxation and tariffs are the most challenging factors impacting KP businesses, according to the survey conducted in the first quarter of FY22.

These are, not surprisingly, in line with the policymakers' understanding of business deterrents. According to the KP Industrial Policy 2020, security challenges, lack of requisite infrastructure, energy crisis, financial constraints, and the absence of a systematic mechanism for ease of doing business are prominent constraints to the growth of the industrial sector in the province.[1] At the outset, this implies that policymakers primarily have an understanding of KP business constraints.

Here is a backgrounder to key issues:

ENERGY

Energy was one of the subjects that dominated the roundtable discussions.

Participants highlighted the following key areas of focus:

i) KP's hydro potential should be harnessed to generate more power
ii) A bulk of the operational hydel generation capacity is owned by WAPDA which needs to pay Net Hydel Profit (NHP) due to the KP government, per the law [2]
iii) Wheeling policies need to be reinforced for hydel-based projects located in KP which would generate revenue for the province
iv) The net hydel fund should be utilized to provide cheaper electricity to KP businesses
v) Energy is costly and unreliable [3]

Pakistan's hydro potential is undoubtedly enormous—about 60,000 MW worth, of which 16 percent has been tapped. Of the total potential, 41 percent or 24,500 MW of it can come from KP. This energy potential is planned to be harnessed through the KP Power Sector business Plan by 2031. If fully materialized, KP's hydropower capacity would be 1.5x-2x of the total supply requirements. This is certainly encouraging news.

But the problem for KP is not so much a question of generation but of centralized control, homogenous pricing, and sparse distribution and transmission networks. The cost of energy across Pakistan is high. The World Bank's Doing Business report puts Pakistan's energy cost at more elevated than the average for South Asia and significantly higher than that for OECD High-Income countries. Pakistan's weighted average consumer power tariff at 12.51 cents/kWh is the highest among peer countries due to increased transmission and distribution losses (T&D), duties, and surcharges, according to an analysis published by the Pakistan Business Council.[4]

With pricing controlled centrally, KP's vulnerable economy has not been able to successfully absorb the high cost of energy, having been hit hard by terrorism and political challenges in the past decades. However, with so many of the upcoming hydro projects planned in the province, the KP government can facilitate the supply of affordable electricity to the business community through wheeling arrangements. Some work has already started.

[1] KP Industrial Policy

[2] Article 161 (2) of the constitution says, "the net profit earned by the federal government, or any undertaking established or administered by the federal government from the bulk generation of power at a hydro-electric station shall be paid to the province in which the hydro-electric station is situated".

[3] If NEPRA's report for DISCOs (FY20) is considered, Peshawar Electric Supply Company (PESCO) had the highest T&D losses among 10 DISCOs and recorded the largest breach of target score of 6.95% (i.e., actual T&D losses higher than the target assigned by NEPRA) against the average 2.23%. During that fiscal year, this led to a financial loss of Rs22.5 billion suffered by the national exchequer, which was 38% of the total financial loss incurred due to breach of NEPRA target by DISCOs. This further leads to unaffordable energy, power shortage and contributes to circular debt.

[4] Pakistan's Energy Security and Competitiveness. The Pakistan Business Council.

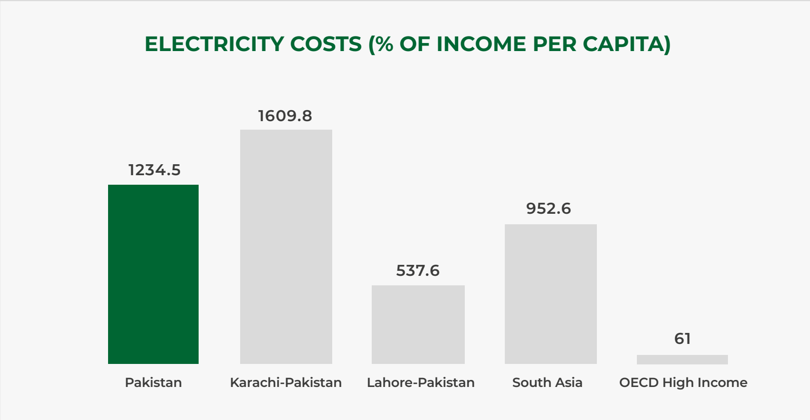
The KP government's plan to exploit the province's hydro potential is:

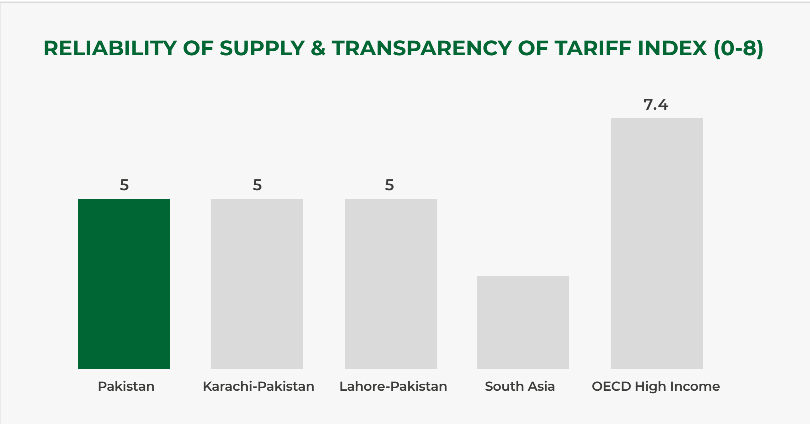
vi) To use its operational public hydro portfolio and provide cheaper electricity to industries in KP through wheeling arrangements.

vii) To develop key hydro projects across hydro corridors in KP under the public sector domain to catalyze the sector's growth.

viii) To facilitate private sector investment by undertaking projects under PPP mode.

ix) To undertake feasibility studies for various regions (Chitral, Swat, etc.) and explore power evacuation possibilities for all future projects.[5]





This measures the duration and frequency of power outages in the largest business city of each economy. This score however is based on two cities. The score also offers points on the economy with mechanisms in place to monitor outages, restoring outages, regulation, and communication of tarifff and tariff changes to customers. These systems were in place in Pakistan which adds to the transparency. The country was awarded 0 score for reliability.

Source: https://www.doingbusiness.org/en/data/exploreeconomies/pakistan#DB-ge

Exhibit 2: World Bank's Doing Business in Pakistan: Energy

Under the KP Hydro Power Policy 2016, over 6,000 MW of energy will be exploited through various public, private, and PPP projects over the next ten years, of which 237MW is under construction. To provide cheaper electricity to businesses and industrial sectors, the KP government has developed a wheeling model for the hydel energy being generated within the province. The cost of energy under the wheeling regime will be lower than the CPPA tariff. In Phase-I, five industrial consumers have signed agreements with Pakhtunkhwa Energy Development Organization (PEDO) powered by the 18MW Pehur Hydro Power Project. In Phase-II, 148MW of energy will be wheeled to pre-qualified Bulk Power Consumers (BPC).[6] Through the wheeling of six hydel projects, the annual benefit to BPCs will be Rs 788 million to the KP province.

[5] KP Power Sector Business Plan 2021
[6] ibid

This project, however, is for industrial consumers (with a sanctioned load of 1MW and above) and excludes a large section of the KP business community consisting of SMEs and providers of wholesale, trade, and services.[7] These businesses can be provided with subsidized electricity using the Hydel Development Fund.

Lastly, for the issue of transmission, the current utilization of KP's hydro potential is constrained mainly by insufficient capacity in the transmission and distribution network to evacuate power from envisaged hydropower projects. Meanwhile, the National Transmission and Dispatch Company Limited (NTDC)'s expansion plan for networks does not account for the hydro projects being undertaken in KP.

To cater to the transmission side of the energy equation, the KP government has established Khyber Pakhtunkhwa Transmission and Grid System Company Limited (KPTGCL) which will develop a transmission corridor between Chitral, Dir, and Swat for evacuation of power from proposed hydro projects in KP's portfolio.[8] At the same time, a unit within PEDO may be developed which will oversee matters related to power evacuation and grid interconnection for projects under consideration. This will improve harmonization and mitigate any disconnect between provincial and federal project developments.[9]

TAX AND FISCAL CONSTRAINTS

Businesses in KP are aware of the government's fiscal limitations but are also distressed with numerous tax-related challenges that impact their business performance. The roundtable participants emphasized that the heavy burden of taxation should be viewed in unity with the burgeoning debt to GDP in the country, which was breaching the limits proscribed under law. Revenue shortfalls necessitated maintaining provincial surpluses, but despite that, the government did not have the fiscal space to spend on provinces. As such, the participants agreed that the KP government had little leverage to influence federal policies. Thus to enhance the ease of doing business, specifically when it relates to taxation, reforms should be focused on provincial tax policies.

Businesses highlighted the following tax administration related issues:

i. Tax culture is extremely weak, which overburdens the existing tax-paying business community. The provincial authorities need to focus on collection and enforcement to expand the tax base and generate additional revenues through expansion in size instead of squeezing tax-compliant individuals and businesses.
ii. The current tax revenue policies are disincentivizing new taxpayers from entering the system.
iii. Refunds are not released (and in a timely fashion) by the Federal Board of Revenue (FBR).
iv. There are several instances of double taxation by the Excise and Tax Department and KP Revenue Authority, which should be resolved.
v. Prolonged tax audits negatively impact businesses.
vi. Sales Tax Concerns: Aside from high sales tax incidence, there is also an ongoing debate about products that fall under the definition of "goods" and "services." Whereas sales tax on goods is to be collected by the FBR, service taxes are managed by the provincial authorities, and there is a duplication of taxes at various instances.
vii. Conflict for Collection of Port Development Levies: This is another case of double-taxation where this tax is being collected by the Sindh government at the seaport as well as the KP government at the dry port. The debate is whether this tax should be imposed at the destination point or the origination, and it should be resolved to avoid double taxation for KP importers.

[7] PEDO and KP Government are also working on mini and micro hydro power and solarization projects targeting off-grid rural households, schools, primary health facilities and worship places.
[8] The company has accordingly filed an application for grant of a PGC license to NEPRA.
[9] KP Power Business Plan 2021

Double taxation and other tax concerns are indeed not exclusive to KP, but according to World Bank's Doing Business report, it is not only more difficult to pay taxes in Peshawar, but the number of tax payments is also much higher in the city compared to other parts of South Asia as well as the rest of the country.

The KP government and relevant departments are working on reforming the sales tax regime (see next section), trimming down inefficiencies, eliminating double taxation, reducing tax rates, and expanding the tax base. Digitization and centralization of tax collections will also resolve many individual tax-related concerns of businesses and make the process easier and swifter. On the other hand, effective tax administration also requires a robust conflict resolution mechanism which should be an essential reform under the new regime.

Exhibit 3: World Bank's Doing Business in Pakistan: Paying Taxes in Karachi & Peshawar

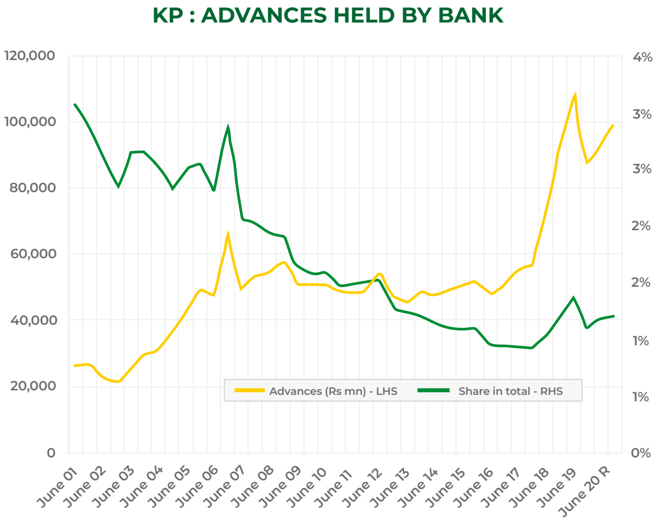
ACCESS TO FINANCE

Lack of access to finance is not exclusive to KP and is frequently a subject of discourse within the business community across the country. Precisely, concerning SMEs, banks have historically steered clear of SME lending due to i) high-risk profile of SMEs that tend to be undocumented ii) On-books information is patchy to non-existent. Additionally, the unavailability of credit history causes information asymmetries iii) history of high defaults during economic downturns created legacy effect iv) high transaction cost for on-boarding new SME borrowers as assessing credit risks is costlier.

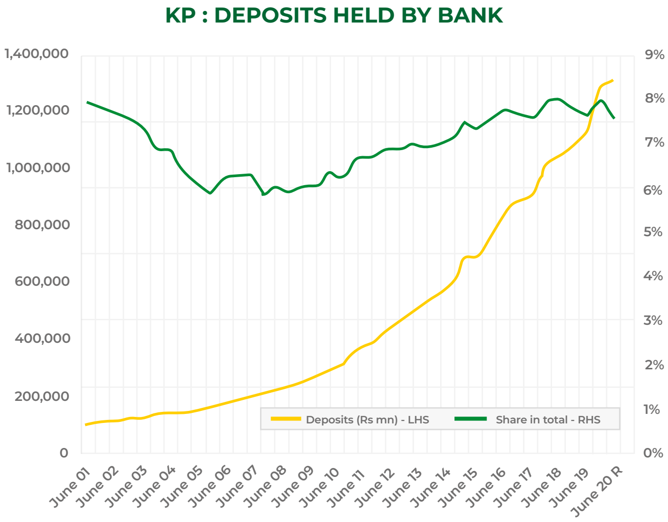
SMEs in KP are typically financed through informal channels. The Business Barometer Survey Q1 showed that 62% of survey respondents used informal means to invest their working capital in KP. Only about 12% of respondents sought and/or were approved loans by commercial or Islamic banks, and 26% used multiple channels. The State Bank of Pakistan's data on advances and deposits by province shows that advances held by banks in KP are slightly above 1% of total advances held by banks in Pakistan. That's paltry! And this share has fallen from 3% in 2001.

During roundtable discussions, participants shared that despite SBP's recent efforts to promote finance to SMEs and underserved segments, KP businesses did not have access to formal finance. They could not avail schemes such as TERF (more details in the later section). They also argued that KP had a significant contribution to bank deposits, and this share has grown over the years, but advances have not kept pace.

Indeed, this is evident from SBP's data since 2001 where deposits share has maintained between 7 and 8% as opposed to advances that are insignificant in value as well as contribution. The province's deposit to advance ratio is one of the lowest amongst provinces.



Source: SBP Half Yearly Outstanding Position



Source: SBP Half Yearly Outstanding Position

Exhibit 4: Advances and Deposits Held by Bank

KP has the lowest number of active borrowers within the microfinance space, following Baluchistan at 2%[10]. Meanwhile, penetration in KP of access points is also one of the lowest. The province has only 4 bank branches for every 100,000 inhabitants, which is higher at 7 for Pakistan. The region also has only 1 branchless bank agent for every 1000 individuals, which is 2 for Pakistan.[11]

Meanwhile, the financial infrastructure in the province is weak, and evidently, very few banks are open to lending to the businesses. As highlighted by a member of the Women Chamber of Commerce and Industry Peshawar, even where quota is applied (in a certain scheme), such as in the case of women-run businesses, these businesses were unable to access formal loans.

In general, roundtable participants agreed that the banking sector in KP kept businesses in the "red-zone." Banks have been wary of loan recovery and political retaliation because of the uncertain law and order situation prior to the merging of the tribal areas and the ongoing geopolitical crises within the province. However, improvement of the security situation within the province should have banks revisit their existing models.

This falls not only on the provincial government to broker collaborative schemes with the SBP but also on the SBP to ensure its current refinancing schemes are equitable and accessible to all provinces and businesses in the country. This can be done by supporting KP banks in building models tailored to the risk profiles of KP businesses. The provincial government can put aside funding for a first-loss guarantee or develop a risk-sharing mechanism with the banks in line with other similar schemes that have been implemented in Pakistan to motivate banks in KP adequately.

[10] Pakistan Microfinance Network (PMN)

[11] Access to credit in Pakistan: Dissecting the demand and supply, Karandaaz Pakistan.

GOVERNANCE AND ADMINISTRATION

Another recurrent theme during the roundtable was poor governance of various departments in KP and lack of business input during policymaking. Participants shared that while relevant departments did not have the required data and information to understand the ecosystem of the KP businesses and industries, chambers representing these businesses or businesses themselves were never involved in policy formulation. Government departments were less likely to involve stakeholders during policymaking or in their exercise to introduce new regulations, tax or reforms.

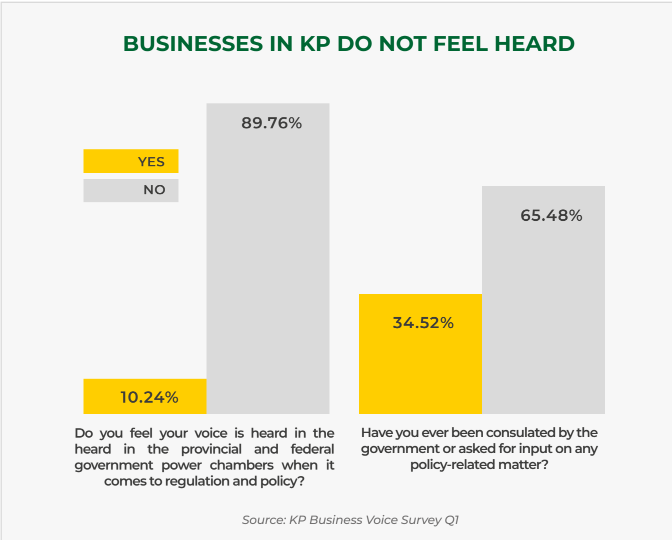


Exhibit 5: Are business voices heard in KP?

Ideally, steering committees should be formed in an advisory capacity to resolve this, consisting of businesses representing all relevant segments. These committees can provide frequent feedback and make recommendations to the government on promoting local businesses and easing their regulatory concerns.

GOVERNMENT POLICIES AND
BUDGET FY22 PAKISTAN AND KP

HIGHLIGHTS OF FEDERAL BUDGET

In general, some measures in the budget (details in **Annexure A**) will positively impact business costs and provide regulatory ease to enterprises across Pakistan. This includes a special tax regime for SMEs, reduction in turnover tax for certain industries, removal of withholding taxes on banking transactions, cash withdrawals, extraction of minerals and other areas, focus on digitization by FBR for better and swift tax compliance, tax credits on point-of-sales, reduction in custom duties of raw materials, exemptions for Special Economic Zones and Special Technology Zones, increase in turnover tax ceiling to support small industries, etc. These will prove beneficial for businesses across Pakistan and in KP. Meanwhile, the federal government expanded the development budget by 37 percent—which is substantial—from last year with enhanced allocation for newly-merged districts of KP.

In addition, to promote the documentation, the government has restored the self-assessment scheme and only 5% cases will be picked for audit through digital balloting. This step is hailed by the business community. On the other hand, all Tier-1 retailers will be required to integrate their computerized system for real-time reporting of sales and receipts with SBP as required under the Sales Tax Act, and those who don't will be ineligible for the tax credit on input. This is a stick to the fiscal carrots under the budget.

At the same time, online marketplaces have also been included in the Tier-1 category. Those running these online marketplaces will be responsible for collecting sales tax on goods being traded through the portal. This move may be counterproductive as it might reduce online activity instead of keeping this avenue open to collect information on undocumented businesses in the country and coax them out of informality.[12]

The federal government must ensure that amendments and relief proposals are not overturned or left unimplemented as rapid policies can discourage business and investor confidence. Policy continuity is crucial. (See **Annexure A** for key amendments under Federal Budget)

BOX I: GOVERNMENT SUPPORT MEASURES FOR STABILIZATION AND GROWTH

The federal government believes that after prudent interventions to stabilize the economy where the twin deficits are under control, the country is entering the growth phase. Over the past year, the SBP has introduced several support measures to achieve stabilization. These include:

1) Lowering the policy rate from 13.25% to 7%.
2) Deferring principal loan payments for a certain period during Covid-19 as businesses struggled to stay afloat.
3) The Central Bank introduced wage support concessionary financing to avoid private-sector lay-offs.
4) A Temporary Economic Relief Facility (TERF) was launched for new plants and existing manufacturing facilities seeking expansion. This facility has been heavily utilized, totaling loans of Rs 453 billion (or 1.1% of GDP) with 628 businesses that availed the facility. This long-term financing is being used for the import of machinery, plants, and other components to finance brownfield and greenfield projects, with nearly 30% going into new projects.

[12] Tax memorandum finance bill 2021, PWC

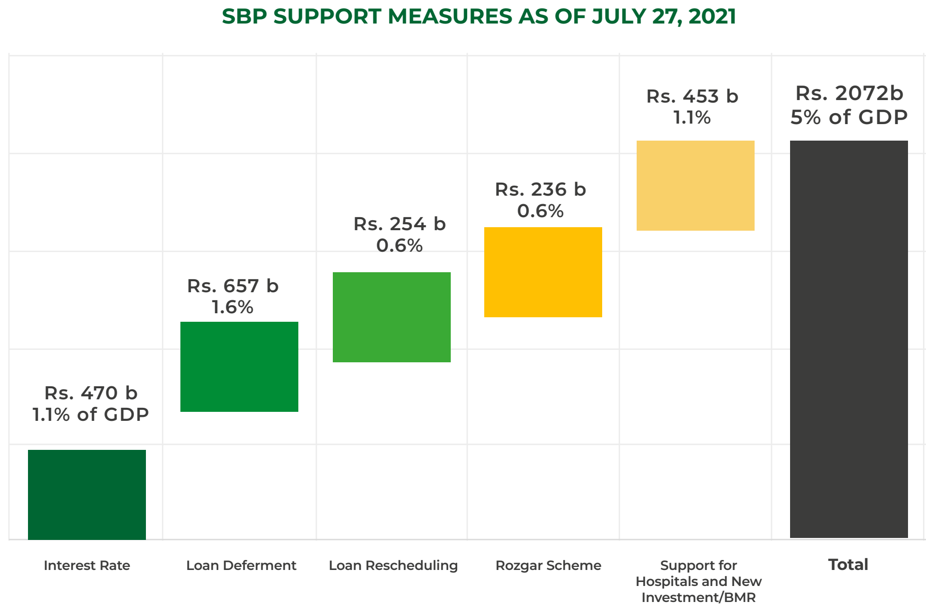


Exhibit 6: SBP Support Measures in FY 21

SBP's total expenditure to fund economic support measures constitutes Rs2,072 billion (or 5% of GDP) as of July-21. However, discussions in the roundtable suggest that KP has not been a huge beneficiary of TERF as banks in KP have not been as active in building their loan portfolios.

The federal government also announced a relief package during Covid-19 that included Rs100 billion for SMEs and farmers. One significant development has been concessionary rates (50% cut in peak tariffs) for electricity usage for SMEs that was implemented in Nov-20. During the same time, a massive construction amnesty scheme was announced that offered various incentives for new construction and building projects. Construction is a major economic segment in the KP province and the housing department in KP has acquired land to build at least 58,000 homes for which some projects are already underway, notably Hangu Model Town, Jalozai Housing Scheme in Nowshera, Mulazai Housing Scheme in Peshawar, Havelian Housing Scheme in Abbottabad and CPEC City in Nowshera.

KP BUDGET AND REFORMS

According to the provincial government, the aim of the KP Budget for FY22 has been to eliminate redundant taxes, provide necessary relief in areas where taxpayers are overburdened, and at the same time enhance the ease of doing business. In addition, the provincial government has been working to reform the tax system, which includes i) developing a framework for property taxation, ii) building capacity of and restructuring KP Revenue Authority (KPRA) to improve sales tax collection, remove tax gaps and expand the sales tax scope, and iii) leveraging technology/IT for taxpayers' facilitation, effective administration of sales tax and audit of sales tax returns.[13]

The following section summarizes important proposals under the KP budget as well as reforms being undertaken by the provincial government, also keeping in view the impediments that were highlighted during the roundtable:

1) LOAN SCHEME FOR COVID-19 AFFECTED BUSINESSES

The KP budget allocated Rs10 billion for businesses that were affected by Covid-19 in the province. The spending will be in the form of a loan scheme disbursed through the Bank of Khyber. A survey conducted by the Pakistan Bureau of Statistics (PBS) found that KP may have been the most affected region by the pandemic in terms of socioeconomic impact, particularly in the form of jobs losses and reduction in income. This indicates businesses had to let go of employees and cut down salaries during Covid. Meanwhile, SEED's Business Barometer Survey for Q1 found that 45% of businesses in KP experienced their production levels shrink over the previous six months while 47% had to reduce their workforce during the period.

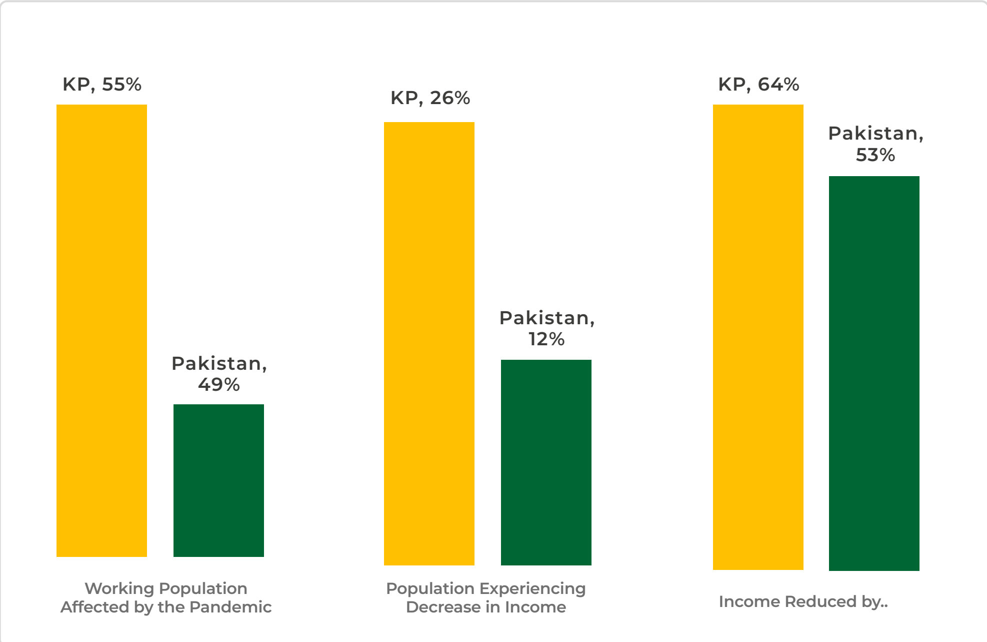


Exhibit 7: PBS Survey to Evaluate the Socioeconomic Impact of Covid-19

[13] Reforming sales tax on services in KP, SEED Improved Economic and Urban Planning in KP

While a loan scheme for Covid-19 affected businesses is a positive measure, it comes down to the brass tacks of the eventual scheme. Roundtable participants raised the issue of access to finance several times. Many argued that the Bank of Khyber is not very active in providing loans to KP businesses, especially SMEs, for various reasons. One reason specific to KP was the law-and-order situation prior to the merging of tribal areas that kept banks away (discussed earlier in the "access to finance" section)

Whereas details for the scheme are not available yet, based on roundtable feedback, the scheme should be designed and tailored based on the borrower profiles, needs, and banks' risk appetite for KP businesses. For instance, many SMEs are undocumented in KP, requiring banks to build alternative data techniques for credit scoring.

2) TAX EXEMPTIONS, REDUCTIONS, AND REFORMS

The KP budget has offered exemptions on bed taxes (applicable on tourist service providers such as hotels and rest houses), professional taxes for 18 professions, and taxes on the transfer of property. Many of these taxes were being dually collected by the Excise and Tax department and KPRA. In addition, entertainment taxes have also been repealed. The vehicle registration fee was also brought down to Re-1, while the re-registration fee and the requirement of NOC from other provinces were abolished.

Removal of double-taxation exercised in the budget is part of the ongoing effort and reform program being carried out by the Excise and Tax department of KP. An internal study (conducted with the support of SEED) found that several reasons were influencing effective collection, transparency, ease of doing business, and citizen facilitation.

(i) The department was collecting eight different taxes, limiting its capacity to concentrate on the most significant ones.
(ii) The processing systems were administered independently at the district level with lax central oversight capability.
(iii) Records were being maintained manually and updated through infrequent staff field surveys, which made modernizing processes difficult.

Roundtable participants were vocal about incidences of double and redundant taxation, which the budgetary intervention will address to an extent. The more extensive reforms needed in the tax machinery are being carried under the aforementioned reform program. After conducting a comprehensive study, it was decided that the Excise and Tax department would focus on two key revenue collection streams with the most significant potential (detailed below).

Urban Immovable Property Tax (UIPT) Under Excise and Tax Reform Program

This initiative aims to strengthen the property taxation system in KP to develop an independent revenue source for the province and drive urban policy. Key steps under the program include:

i. Amendment of the law to ring-fence UIP taxes to spend them within the territory from where they are collected.
ii. To get taxpayers involved by establishing a feedback system to gather local recommendations for spending in their communities.

iii. To develop an MIS system integrated with GIS maps of KP's urban centers. A GIS survey in Peshawar was completed that mapped all urban properties. The same for Nowshera and Abbottabad is underway,
iv. To bring transparency, a self-assessment program is introduced where taxpayers can calculate their own UIPT taxes and deposit the amount.
v. Challans include detailed calculations so taxpayers can verify the amounts.
vi. Tax rates are reduced to broaden the tax base and reduce the burden on existing taxpayers.

As implementation grew, the UIPT collection went up 93% during FY21 despite the department cutting back on different types of taxes and reduction in rates.

Car Registration/token Collection Regime Under Excise and Tax Reform Program

A study conducted in KP found that 80% of vehicles on KP roads were registered outside the province. There are systematic reasons for that.

> Roundtable participants highlighted that law enforcement agencies and excise departments in jurisdictions other than KP often resorted to harassment of vehicles registered in KP, which disincentivized more owners to register their vehicles in other provinces. This culture, they argued, has hampered market perception of vehicles registered in the province, which has negatively impacted the resale value of these vehicles. The resale value for vehicles with a KP number plate, as a result, is comparably lower than other provinces, which further deters car users from registering with the province.

This issue is well-acknowledged by the Excise and Tax department. As a result, the proposed reforms revolve around rebranding the KP number plate to attract vehicle registration in the province. In addition:

x) All records have been digitized and centralized. A universal plate number can be launched.
xi) An e-payment system is developed where citizens can view and pay their outstanding token challans online.
xii) The introduction of a smart card and a universal plate number with security features in line with international standards would build the confidence of KP residents to register in the province.
xiii) This will generate more revenue which will pay for the maintenance of KP road infrastructure.

> *It is also imperative for the department to develop a complaint management system or dispute resolution mechanism where citizens can issue complaints related to harassment and get them resolved, which will help in the confidence-building of businesses and individuals.*

3) REDUCTION AND RATIONALIZATION IN SALES TAX

Sales taxes have been reduced across 31 sectors in the KP budget.[14] This is once again part of an ongoing exercise undertaken by the relevant government departments in order to reform the sales regime of the province. Provinces are responsible for legislating their own sales tax on services regime. A framework for sales tax reforms has been in development by the KP government with the technical support from SEED, where reforms are implemented by KPRA.

The reform program has worked on:

i. Increasing scope from 13 services to 46 services.
ii. Classification of services based on international practices.
iii. Increasing the use of IT through Data Integration and Data Scraping, RIMS, E-IMS, E-courts, E-Strive, and SMS portals, which have helped in broadening the tax base, improving real-time connectivity with businesses, and enabling better performance management of staff.

[14] 10 sectors where sales tax is only 1%. Hotels and restaurants located in Naran and Kaghan: from 8% to 5%. Services relating to mines and minerals including government, royalties, licenses: from 15% to 2%. Agriculture-related services that were covered under different tax slabs: 2%. Services provided by clubs and local standalone and local chains of hotels: From 15% to 8%.

iv. Creating tax payer awareness of rules/ laws to improve voluntary tax compliance.
v. Developing mechanism for mass audit by qualified tax compliance officers based on risk criteria.

The federal government is currently working on the harmonization of sales tax with the help of the International Monetary Fund (IMF) to create a National Tax Council. The KPRA will have to work with other provinces' revenue authorities to develop consensus and integrate the services tax. Lack of harmonization is causing production inefficiencies and incurring costs to taxpayers.If/when successfully implemented, these reforms will resolve many of the current issues faced by the KP businesses (highlighted specifically during the roundtable).

4) PROMOTING INVESTMENT AND EASE OF DOING BUSINESS

During the roundtable discussions, representatives from KPRA informed that significant changes were being made to create ease in doing business. These include cutting down red-tape for business registration processes, the introduction of simplified procedures with collector appeals, and amendment processes to facilitate tax adjustments. During the roundtable, it was also learned that with the help of the KP IT Board, the province is working on a one-stop portal for all business-related activities, including registration, getting utility connections, paying taxes, etc. This business facilitation platform will cut down red tape, increase transparency, and reduce lead times substantially, contributing to the competitiveness of businesses.
It has been recommended that the portal must include a grievance redressal tool where businesses can voice specific concerns or challenges and which can be routed to the relevant department or institution to be resolved by them.

5) KP INDUSTRIAL POLICY

The KP Industrial policy was approved by the Cabinet in Dec-2020 and is currently mulling an action plan for its implementation. The policy framework focuses on:

i) Building ease of doing business for foreign and domestic investors.
ii) Creating a "pull factor" for foreign investors to form joint ventures with local companies.
iii) Providing necessary and quality infrastructure through PPP mechanisms.
iv) Enabling access to utilities under a one-window operation for all industries
v) Developing industrial zones and Special Economic Zones (SEZs) to create industrial clusters in the province.
vi) Facilitating access to affordable finance.
vii) Revitalizing old and sick industries.

The policymakers believe that these interventions will not only attract new investors but also bring new technology to the province, and boost labor-intensive and export-oriented industries. **Annexure B** summarizes the policy pillars and key interventions envisaged at each step of the policy implementation.

The policy has also formed a 14-member committee that includes Industries and Commerce members, Directorate of Industries, Small Industries Development Board (SIDB), President Women's Chamber of Commerce and Industry, and President Sarhad Chamber of Commerce and Industry (SCCI). They all are—to a great extent—representative of the business community in KP. The committee will be responsible for developing a policy strategy, monitoring its implementation, and devising a mechanism for grievance redressal. As such, this policy is not stagnant and can be built upon over time, given its collaborative nature. It gives importance to business voices and grievances, which is an integral component of business facilitation.

RECOMMENDATIONS

Macroeconomic impediments that adversely impact businesses, such as uncertain economic conditions, high inflation, interest rates, and expanding debt, may not be areas where the KP government can interfere as these are federal domains. However, there are several prominent areas where provincial government and policymakers at the top and provincial institutions and departments in the middle can bring actionable changes to improve business and investment climate, especially in light of the vision underlined in the KP industrial policy.

Based on recommendations and suggestions highlighted during the post-budget roundtable, following are the strategic areas for the provincial government and its departments to focus on:

1) THE EXISTING TAX ADMINISTRATION IS COMPLEX AND BURDENSOME ON THE TAXPAYERS AND RIDDLED WITH INEFFICIENCIES THAT SHOULD BE RESOLVED

The KP government is overhauling the provincial sales tax regime by expanding the tax base while rationalizing rates and attempting to harmonize the system with the rest of the country. Meanwhile, the Excise and Tax department is diverting resources to eliminate redundant tax measures while focusing on two primary revenue sources: property and vehicles.

Roundtable stakeholders suggest that while government must continue its current efforts toward provincial tax reforms, in the next step, it must streamline coordination with provincial revenue bodies to eliminate redundant and double taxation across the system. This would reduce the unnecessary cost burden on businesses and shrink down compliance time (as well as paperwork).

In addition, the collection and tax enforcement side of the system must be strengthened to bring more businesses into the tax net while reducing the burden of meeting revenue targets on existing taxpayers.

Most importantly, the provincial revenue authorities must integrate their systems with FBR to ensure that KP businesses which are registered in the federal system and adhering to federal tax laws are also compliant with provincial taxes.

2) THE BUSINESS AND INDUSTRIAL POWER ISSUES SHOULD BE RESOLVED THROUGH WHEELING MECHANISMS AND ENERGY SUBSIDIES, WHERE POSSIBLE

KP has enormous hydro potential. To utilize this potential, a host of new hydropower projects is in various stages of development. After the first successful wheeling model for 5 industrial consumers with power evacuated from Pehur Hydropower Project, Pakhtunkhwa Energy Development Organization (PEDO) is poised to wheel electricity to 79 bulk-purchase consumers. Wheeling provides cheap electricity to the industrial customer and generates revenue for PEDO and Distribution Companies (DISCOs). The wheeling agreements however are only accessible to operational or under construction industrial projects in KP with a connected load of 1MW or higher. Transmission-related reforms underway are also crucial.

If PEDO wheels electricity to various other Distribution Companies, it can generate even more revenues. It has been recommended that a) the KP government first get its net hydel profit dues from WAPDA released ii) the net hydel fund can be utilized to provide energy subsidies to businesses and enterprises in the services and wholesales trading segments who cannot enter into wheeling arrangements with PEDO.

3) THE KP GOVERNMENT MUST REPOSITION THE PROVINCE IN FEDERAL-LEVEL INTERVENTIONS SUCH AS SBP FINANCING SCHEMES AND ENSURE THAT KP BUSINESSES ARE INCLUDED AND INVOLVED

The Central Bank in the current regime is very active in boosting financial inclusion and access to finance of businesses and other underserved segments. Whether it is the subsidy program announced under the massive Naya Pakistan Housing Program (NPHP), the stabilization program over the past year, or the newly announced scheme for SMEs; the SBP is going all out to generate much-needed liquidity in the market that would give the requisite push to the real sectors.

The latest announced scheme will provide financing to SMEs without collateral, where the government will cover 40-60% of the default risk, and facilitate loans for SMEs at subsidized rates which are substantially lower than informal market rates. This scheme has institutional learnings,[15] supported by the improved regulatory and legal environment, and can be a massive success for the central bank. But the scheme is for those banks that are serious about expanding their SME portfolio size.

KP businesses have expressed that they do not have access to finance in the province or access to federal government schemes. Though loans to the private sector in the country through the banking channels have grown over the years, this growth does not reflect in numbers for KP. This indicates that while banks are slowly opening up to private-sector lending, KP businesses have remained on the backburner. Our understanding is that banks steered lending to the private sector in KP due to various political reasons, but with the geopolitical situation improving in the region, banks' willingness to lend money to the businesses and SMEs can increase.

With a new scheme specially designed to provide clean or undercollateralized loans to SMEs,[16] this may be the time for the provincial government to step in and ensure KP businesses get a portion of the pie. This can be done with the support of chambers, business associations, and organizations like SMEDA who can together work on specifically i) improving the preparedness of KP businesses to meet qualifying loan criteria such as maintaining financial records and proper book-keeping, etc. and ii) facilitating Bank of Khyber to build its loan underwriting capacity and tailor it to the risk profiles of KP enterprises, especially SMEs.

4) THE KP GOVERNMENT CAN FACILITATE ACCESS TO FINANCE THROUGH TARGETED SUBSIDIES AND GUARANTEES AS A PLANNED AND BUDGETED INTERVENTION FOR THE KP BUSINESS COMMUNITY

Businesses in KP simply do not have enough liquidity to grow and expand their businesses and explore new investment opportunities. Project-based financing, working capital, trade financing, or long-term financing is currently being served to very few KP businesses by very few commercial or Islamic banks. Businesses have to rely on equity sharing or turn to the costly informal markets to keep businesses afloat and grow.

[15] Clean or uncollateralized lending is not an easy venture but the SBP has learnt many lessons during the credit guarantee program for SMEs it ran between 2010 and 2020 with the funding support of DFID.
[16] Remember, that adequate and titled collateral is one of the most important prerequisites for lending in the banking sector

The provincial government can step in to alleviate both supply and demand-side constraints in lending. By allocating provincial funds—or even seeking funding and technical support from an international organization like FCDO or World Bank—a provincial financing scheme can be developed for businesses registered in the province. The government can adopt mechanisms that have worked in the past, such as risk-sharing models and first-loss guarantees to reduce banks' default risks and subsidies that target priority sectors or SMEs that could benefit from more affordable loans. The modalities of such a scheme can be developed with the technical support of organizations that have extensive experience in the area.

5) A DIGITIZED, TRANSPARENT, SOLUTION-ORIENTED CONFLICT/ GRIEVANCE RESOLUTION MECHANISM SHOULD BE ESTABLISHED TO ELIMINATE INEFFICIENCIES IN THE PROVINCIAL REGULATORY REGIME

Businesses in KP claim that they have to deal with far too many government departments when conducting business where functions and roles often overlap and conflict with each other. As a result, there are many inconsistencies and inefficiencies within the regulatory machinery that makes doing business cumbersome and tedious.

The one-stop business forum currently in development must have a robust grievance resolution mechanism with efficient and timely redressal of complaints. For the tool to effectively work, all relevant government departments will need to have dedicated resources assigned to the system and be able to collaborate and coordinate with other departments and regulatory bodies to resolve challenges at the micro-level within the regulatory system.

6) THE KP GOVERNMENT MUST SET UP ADVISORY COMMITTEES WITH REPRESENTATIVES FROM THE PRIVATE SECTOR TO CURATE PRO-BUSINESS POLICIES, REGULATIONS, AND BUDGETS

Whereas industrial chambers and associations routinely submit their recommendations to the government during the budgetary exercise, businesses do not feel heard or represented in the budget or policymaking of the KP government. This gap needs to be filled through the formation of the steering committees.

These committees can consist of businesses representing relevant economic segments as advisory and consultative bodies before any provincial interventions (such as fiscal measures during budget exercise, sales tax reforms, KPRA reforms) are planned.

*ANNEXTURE A: AMENDMENTS AND PROPOSALS AIMED TO REVIVE THE ECONOMY AND FACILITATE BUSINESSES

BUDGET MEASURES	COMMENTS
Introduction of Special/ simplified tax regime for small and medium enterprises (SMEs) engaged in the manufacturing sector	SMEs can opt for a Fixed Tax Regime (FTR)[17] and will not be subject to tax audit
The final tax regime for export of services at 1%	This is at par with the export of goods and will include computer software, IT, IT-enabled services, technical services, and construction contracts executed outside Pakistan
Reduction in the general minimum tax rate on turnover from 1.5% to 1.25% with an enabling provision to carry forward the minimum tax for loss-making entities	These are lowered much further for certain segments, such as dealers and distributors of fertilizers and oil refineries.
Telecommunication companies included in the definition of industrial undertaking	This will help telecom companies to have the same tax treatment as industrial companies
Abolishment of 12 withholding tax provisions	This includes WHT on the extraction of minerals, cash withdrawals, banking transactions, etc.
Saving the benefits accrued under expired/repealed exemption provisions	An abrupt withdrawal was carried out for certain tax exemptions and concessions through the Tax Laws (Second Amendment) Ordinance 2021. A clause is proposed to provide continuity of exemptions and concessions for businesses who qualified but did not accrue the benefits.
Facilitative provisions relating to exemption certificates for the corporate sector and tax credit entities	This facility available to public listed companies has been extended to all companies
Electronic processing of refunds	FBR can issue refunds to the taxpayer (filer) directly to their bank on the basis of tax credit verified from FBR's automated system.
Tax credit for Point of Sale (POS)	A tax credit is proposed for businesses that purchased POS machines
Curative amendment for minimum tax exemption on Special Economic Zone entities	This is in addition to no income tax for ten years since operations start
Rationalization of amendment proceedings and introducing a time limit for finalization of income tax proceedings	
Abolishment of sales tax on advances	
Increase in the threshold for sales tax exemption of Cottage Industries	The threshold for turnover tax has been raised from Rs 10 million to Rs 100 million. This is an important development that will lower the tax burden on small enterprises
Exemptions and concessions introduced for Special Technology Zones	10-year tax exemptions from profits and gains of Special Technology Zone enterprises as well as CGT exempt from investment in these enterprises
Introduction of a new concept of Border Sustenance Market (BSM)	The BSM is a tool to boost local trade and economic activity in the border regions to enhance bilateral trades. The proposal would reduce fencing and smuggling by creating tax-exempt zones. Currently, in trade with Iran and Afghanistan, certain goods will be exempted from customs duty, sales, and income taxes.
Exclusion of listed companies from the restriction on claim of input tax beyond 90% of output tax.	

[17] 0.25% of gross turnover (where turnover does not exceed Rs 100 million) and 0.5% where turnover is between Rs 100 million to Rs250 million.

* Federal Budget FY22

Reduced WHT on specified services	These include Oilfield services, telecommunication services, warehousing services, collateral management services, and Travel and tour services. A large portion of KP businesses is part of the services segment, especially the tourism sector, which will benefit from a reduced WHT of 3%
Reduced rate for women enterprises	Businesses solely owned by women or AOP where women hold all 100% shareholding will incur a reduced rate of 25% on business income.

*ANNEXTURE B: KP INDUSTRIAL POLICY: KEY PILLARS

PILLARS	INTERVENTION
Revival and rehabilitation of sick industrial units Instability in government policies, financial mismanagement, lack of management skills, poor business planning, unavailability of skilled workforce caused as many as 114 industrial units to shut down. These included steel, plastic, pharmaceuticals, textile, food, and PVC pipe industries.	The policy aims to provide uninterrupted utilities (electricity and gas), help create robust supply chains, and revive 25% of sick/ closed units within 5 years This will be done by providing financial and non-financial incentives, seek investment through repositioning KP as a growing business hub, explore avenues for joint ventures with investors, and develop mechanisms with federal/provincial agencies for a reliable supply of utilities.
Improve the infrastructure and allied facilities to cater to the growing demand of existing industrial estates and Economic Zones Businesses within industrial estates suffer from unreliable power supply, lack of quality road infrastructure, and non-standardized designs for industrial units and warehouses.	The infrastructure development is being envisioned under PPP and ADP structures. A timeline of 30 days is mapped out for the provision of utilities. The provision of electricity will be done by wheeling under NEPRA Regulations 2015.
Provide an effective framework for One-Window Facilitation of investors The current business environment involves interaction with multiple federal and provincial departments and stakeholders, while important information related to doing business is scattered and often inaccessible.	The one-stop shop is being developed by the KP-BOIT, which will create linkages between industries, government departments, and regulators.
Equitable and Strategic development of Industrial Zones, SEZs, and Sector-Specific SEZs	The government has planned to develop 10 industrial and SEZs, at least two of which will be developed within 5 years under the PPP arrangement. The objective is to: **1) Encourage PPP and JVs between foreign and local investors** **2) Encourage logistic companies to invest in logistic parks** **3) Ensure availability of finance by commercial banks with a focus on Bank of Khyber** **4) Improve regulatory framework and eliminate duplication** **5) Develop R&D structures** **6) Skills development matching with industrial demand** The following incentives have been announced: **i) Exemption from provincial electricity duty for new and expansion projects** **ii) One-time duty- and tax-free import of capital goods for plant and machinery** **iii) Exemption of all income taxes for 5 years for developers, and for 10 years for Zone Enterprises** **iv) Exemption of tax on transfer of sick unit property and repatriation of profit for foreign investors** **v) 25% concessions on land lease charges till breakeven/3 years. For gov. land, the acquisition of land will take place over 5 years with 25% down payment instead of upfront payment.** The focus will be on cottage and SME industries in sectors such as construction, automobile, pharmaceutical, electronics, apparel, transshipment, IT and food and labor-intensive industries There is a special incentive package for industries in newly merged areas (NMAs).

* KP Industrial Policy 2020

Support to SME's and Cottage Industry The cottage industry in KP is marred by lack of infrastructure, inaccessibility to formal finance, use of outdated technology and methods which have stunted their growth, and unavailability of cluster mapping.	The government is planning the establishment of 19 Small Industrial Estates in ten years, and 16 cottage industry zones have been identified across several KP districts. A specialized cell at SIDB and KP-BOIT will be set up to promote and facilitate SMEs and Cottage Industries. Informal industrial clusters such as marble, food, electric turbines, handicrafts, dresses, etc., will also be facilitated.
Develop a critical mass of quality skilled men and women workers and leverage them to boost productivity (Improving Literacy Low to Medium Tier Skills) There are 58 institutes in KP for technical education in which about 26,000 students are enrolled. However, there is no data on their skills efficiency and adequacy to meet industry demands.	The policy hopes to: **1) Integrate these technical institutes with industries** **2) Attract investment in vocational training** **3) Set up Model Vocational College in collaboration with Chinese Vocational Colleges for skills development under CPEC**
Leverage the natural resources of KP to make its industrial sector competitive The province is blessed with significant natural resources, including industrial-based mines and minerals, hydel, oil, and gas, but KP is not utilizing these resources optimally.	The policymakers intend to encourage industries based on available natural resources by providing them with the right incentives and regulatory environment. Many of these will be part of small and large industrial zones, cottage industries, and SEZs.

*ANNEXTURE C: KP INDUSTRIAL POLICY: INCENTIVE FRAMEWORK

FISCAL INCENTIVES

1) Exemption from Provincial Electricity duty for new and expansion projects/industries
2) Initial installation and BMR facility for one time duty- and tax-free import of capital goods (plant and machinery).
3) Exemption of tax on the transfer of the sick unit property (only for Industrial purpose)
4) Repatriation of profit for foreign investors subject to prevailing laws and commitments.

NON-FISCAL INCENTIVES

1) One-stop shop one window facility jointly operated by KP-BOIT & KPEZDMC (for SEZ) (facilitation for licensing, registration, regulatory awareness & compliance)
2) Simplification of documentation procedures for different purposes.
3) Encouragement to SMEs for branding of their products.
4) Innovation-based diversification by SMEs through Government supported R&D.

FINANCIAL INCENTIVES

1) 25% concessions on land lease charges till break even or for a period of three years whichever is earlier.
2) In case of Government land, acquisition of land in installments over a period of 5 years with 25% down payment. (Instead of upfront payment).
3) GoKP shall subsidize 15% of the transport cost one time (based on import document, enroute weighment document, toll receipts applicable for 20f container and above) from Karachi/Gwadar Ports to industrial site against import of plant and machinery for setting up new units.
   - This subsidy shall be available for all new capital goods/plant and machinery reached into industrial sites for installation.
4) For women entrepreneurs, GoKP shall finance 25% of the equity investments subject to maximum of Rs 30 million per investor.

REFINANCE SCHEMES FOR SMES (SHARIAH COMPLIANT)

1) Refinance Facility for Modernization of SMEs: This will be applicable for modernization of existing units or setting up of new SME units and for the local purchase/ import of new machinery. The loan tenor is 10 years including grace period of 6 months
2) Refinance Scheme for Working Capital Financing of Small Enterprises & Low-End Medium Enterprises: This will be a short-term financing facility for selected SME sectors .[18] The loan will have a tenor of 1 year.
3) Mechanism: The mark-up will be 6%. 2% will be borne by the SME while GoKP will absorb the rest. The maximum loan size is Rs 20 million with a LTV of 70%. The scheme would be carried out through Bank of Khyber.

PAKHTUNKHWA KAROBAR SCHEME (SHARIAH COMPLIANT)

1) Revolving fund at least Rs 3 billion of the GoKP with Bank of Khyber for till Dec-25
2) Loans will be available at mark-up of 4%, of upto Rs 20 million for SMEs, at an LTV of 70% with a tenor of 10 years.
3) Both project financing and working capital needs can be met.

[18] including IT, Furniture, Surgical goods, Dates processing, Gems and Jewellery, Leather industry, Fruits, Vegetables, Food processing, Packaging, Printing
* KP Industrial Policy 2020

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