



PRE-BUDGET FISCAL POLICY PROPOSALS

for

THE GOVERNMENT OF KHYBER PAKHTUNKHWA

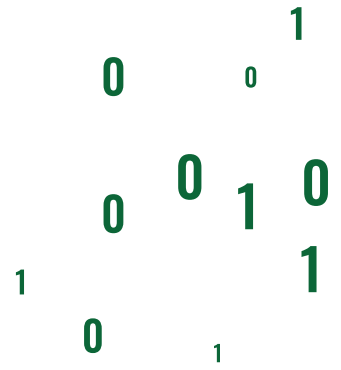
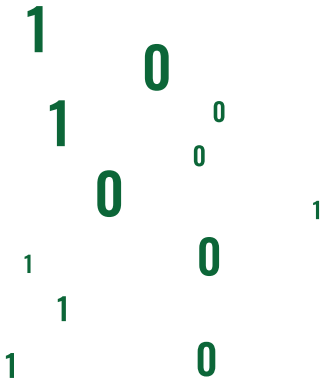


MAY 2022



بابا صبير





FOREWORD

Sarhad Chamber of Commerce & Industry (SCCI) was formed and functions to protect and serve the rights of the business community of Khyber Pakhtunkhwa. It strives with the prime objective of stimulating the trade, business, and industrial activities in the Khyber Pakhtunkhwa and in the surrounding tribal belt.

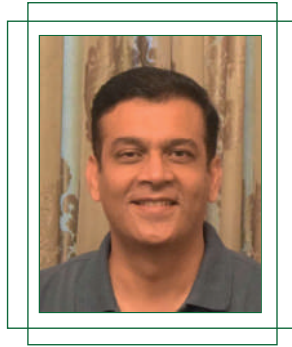
In this regard, SCCI has collaborated with the FCDO-funded Sustainable Energy & Economic Development (SEED) Programme to raise the concerns of the business community of the province to the relevant authorities and ensure that the demands and recommendations of these key stakeholders are brought to the notice of the Government of Khyber Pakhtunkhwa (GoKP). This is crucial to bring about inclusive development in the province, i.e., development which is spurred by and benefits all the people of the province and the business community, which works day and night to bring about economic stability and growth in the province.

The pre-budget consultative session, in this regard, brought together key private stakeholders from all over the province, including representatives from provincial chambers, to put forth their recommendations to the GoKP. This insightful report summarises succinctly the problems and issues of the business community, and very clearly jots down the solutions to these issues and other proposals for the economic strengthening of the province. Some of these proposals are simple and easy to implement, while others are more complex and will require more work on the part of the authorities. It is now up to the government to take this forward and play its part in this mutually beneficial partnership.

I congratulate all the stakeholders involved in this momentous effort. As an advocate of economic development, inclusive growth, and prosperity, the Sarhad Chamber hopes the efforts put together by our team, along with the valuable support of the Sustainable Energy & Economic Development (SEED) Programme, will go a long way in benefitting the business community as well as all common citizens of the province.

HASNAIN KHURSHID

PRESIDENT, SARHAD CHAMBER OF
COMMERCE & INDUSTRY
(SCCI)



FOREWORD

With the budget for fiscal year 2023 right around the corner, the Sarhad Chamber of Commerce & Industry and the FCDO-funded Sustainable Energy & Economic Development (SEED) Programme, as part of their Khyber Pakhtunkhwa Business Voice initiative have brought together important stakeholders from Peshawar and Khyber Pakhtunkhwa's private sector business community, with the aim of formulating fiscal policy proposals for the upcoming annual budget of the Government of Khyber Pakhtunkhwa (GoKP).

A persistent issue reported by the business community in KP is the lack of meaningful engagement with businesses and industries on the policymakers' end. To facilitate their growth, SEED is committed to continue supporting all the stakeholders, i.e., government, business chambers, and enterprises in the province and assist the government in its continuous efforts to strengthen its collaboration with the business sector. Khyber Pakhtunkhwa Business Voice strives to provide an opportunity for KP businesses to articulate the issues and challenges faced by them. The aim of KPBV is to promote open and strengthened dialogue between the KP leadership and the business community and create synergies between key stakeholders to achieve long-term sustainable growth in the province.

Many key issues have been highlighted in this report. Businesses in KP particularly complained about the problems around the tax regime, including harassment by tax authorities, high tax burden on existing taxpayers, difficulties in the payment and filing procedures, and lack of incentives to enforce government's measures such as digitizing payments. The government must now focus on measures to improve the investment climate in KP, especially the cost & ease of doing business, as it has the potential to resolve a host of extant challenges related to the economy. It must also ensure all its efforts are inclusive and take into account valid demands of all stakeholders and support the contributions of women and all other marginalized groups.

This note, highlighting the main issues and proposing recommendations for the upcoming budget, connects voices of businesses from different regions and areas of the province, including regional chambers, women entrepreneurs, representatives from manufacturing, tourism, IT, and other industries, with the top-level Government of Khyber Pakhtunkhwa officials responsible for formulating the budget. SEED and SCCI are playing this crucial role of liaison with the hopes of bringing about inclusive economic development and assisting the government in achieving its vision of a prosperous Khyber Pakhtunkhwa.

DR. OMAR MUKHTAR KHAN
TEAM LEADER, SUSTAINABLE ENERGY &
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PROGRAMME

KP BUSINESS CHALLENGES AND POTENTIAL GOVERNMENT INTERVENTION

Khyber Pakhtunkhwa (KP) is the fastest growing province in Pakistan in terms of population—housing nearly 11 per cent of the country’s people—but its economic contribution and growth has remained limited. Over the last decade, the province contributed about nine per cent to the national GDP. In the past, recurrent political conflicts and geostrategic instabilities hindered growth but now with the improved security situation and some geopolitical challenges at bay, the province has greater opportunity to leverage a number of potential growth drivers. For instance, KP’s geographic location can enable regional trade for Pakistan, beyond Afghanistan, into Central Asia and Europe; its natural resources such as the immense hydro potential can contribute to the country’s energy generation as well as the province’s revenue collection through hydel profits; and the province’s scenic beauty and sites offer opportunities for its tourism industry. Other sectors such as agriculture, mining and construction also have economic potential.

What is needed for policymakers now is to craft a plan of action to mobilize and attract new investments into key business sectors, make doing business easier and expand development and public expenditure on energy, transport, skills development etc. However, considering the federal budgetary challenges, the ongoing twin crisis of a current account and budget deficit and KP’s own limited fiscal space, the focus must be on developing regulatory expediency with an efficient revenue collection system and targeted expenditure.

CURRENT ECONOMIC CONDITIONS



Pakistan’s economic conditions have become difficult in the past year with shrinking fiscal space, rising inflation and a worsening current account position, necessitating external financing requirements and external debt. The spiraling commodity prices in the international markets have turned into a super cycle; the onslaught beginning with the demand resurgence in the aftermath of the end of covid-related restrictions, followed by the Russia-Ukraine war. The chart shows S&P Goldman Sachs Commodity Index (GSCI) for the past five years (Fig 1); the chart demonstrates a sharp uptick in commodity prices since 2020 fueled by oil which is the world’s most traded commodity. Since the onset of the Russia-Ukraine war, oil prices have surpassed \$110 per barrel, the highest since 2011. The S&P GSCI is set to cross its historic peak reached in 2008 during the global financial crisis that began with the collapse of the US housing market.

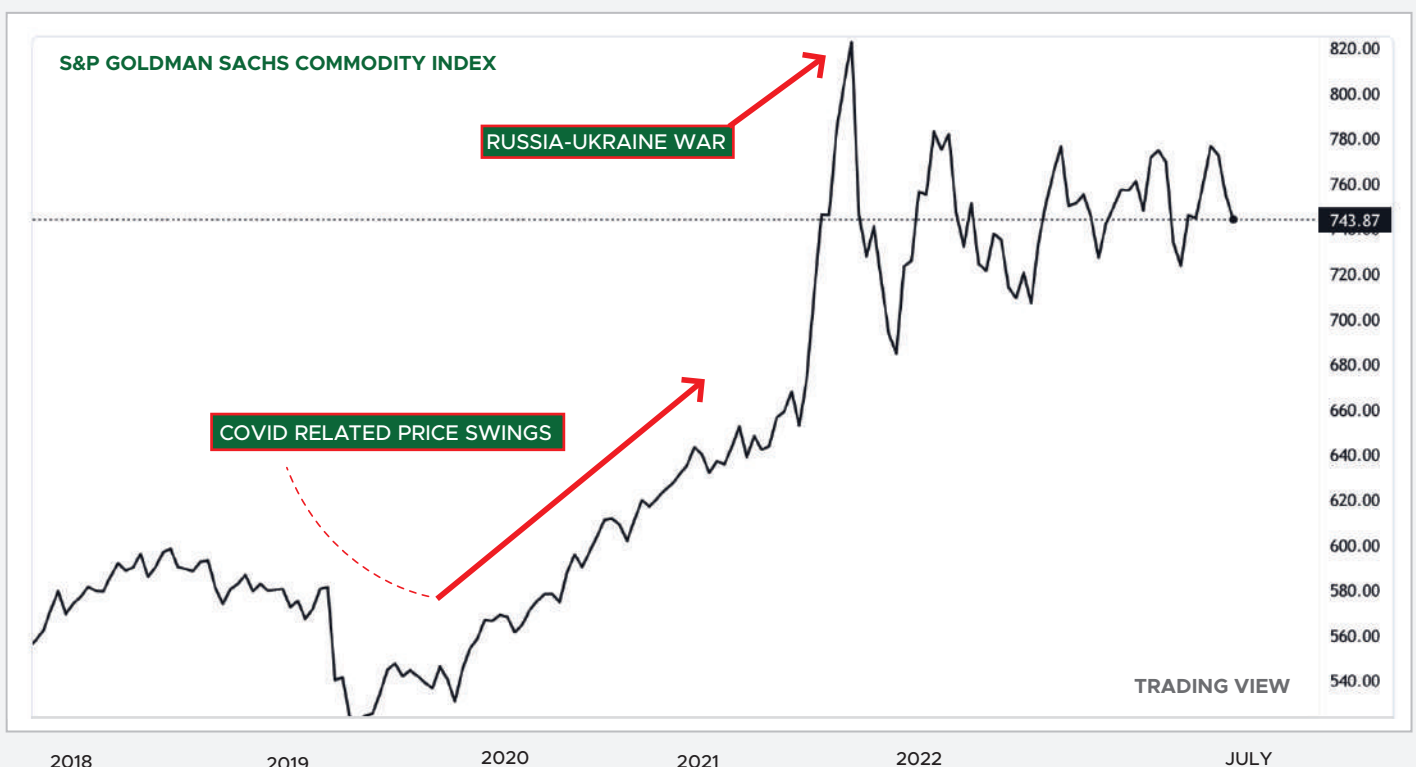


FIGURE 1: S&P GOLDMAN SACHS COMMODITY INDEX 2018-2022

Here at home, political uncertainties with the government ouster have not helped matters. The country has dwindling foreign exchange reserves with limited ability to raise debt from the market at decent rates (Fig 2). This necessitates continued support from the IMF which comes with strings attached i.e., measures to reach fiscal consolidation by eliminating energy subsidies, or reducing/doing away with tax exemptions enjoyed by many business segments. The former will lead to hikes in petroleum and electricity prices which would aggravate inflation.

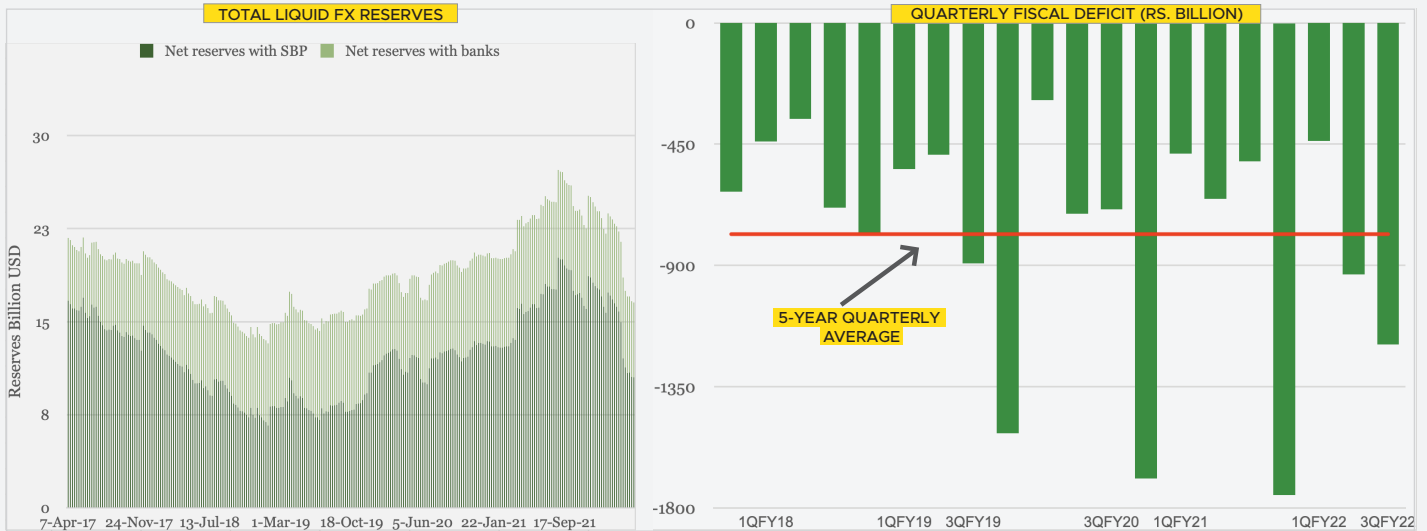


FIGURE 2: PAKISTAN'S FX RESERVES VS FISCAL DEFICIT

Meanwhile, the latter is already under implementation since corporate income tax exemptions have been removed. In the upcoming federal budget, a host of GST exemptions (mainly related to agriculture) could be removed along with those on personal income tax. At the same time, new tax provisions cannot be ruled out. The confluence of these macroeconomic factors will lead to even higher inflation from the current 13% (Fig 3), which will then be countered by a hike in policy rate. The currency will remain under pressure. Tax burden will increase while government spending will also be curbed to allow for debt servicing. The World Bank has already revised down the country's GDP growth rate from the earlier expected 5.6% to 4.3% for 2022.

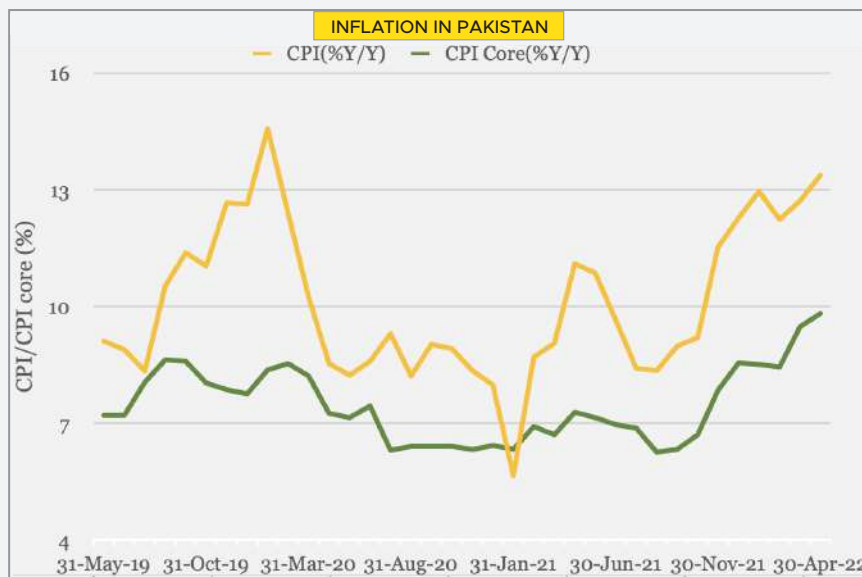


FIGURE 3: INFLATION IN PAKISTAN

As such, this economic scenario is not conducive to business and economic growth and the burden to support and/or facilitate businesses to keep operating falls on the provincial government. In the immediate term, the KP policymakers must craft a budget to help businesses withstand the shocks they will face in terms of inflation and higher taxation while also sustaining growth.

BUSINESS CHALLENGES IN KP

KP businesses mostly comprise SMEs which are adversely hit by the commodity price super cycle (similar to the 2008 crisis), domestic inflation and current taxation levels. Businesses in KP have natural disadvantages, compared to Punjab and Sindh. The province is located at a longer distance from the ports and demand hubs. Manufacturers in KP have to pay more for the transportation of raw material from the seaport in the south to their factories and then send back the processed goods upcountry (for domestic sales) and to the port for exports. The cost of transportation for them—given higher shipping and freight rates overseas, and gas/electricity prices here at home—will substantially raise their cost of production.

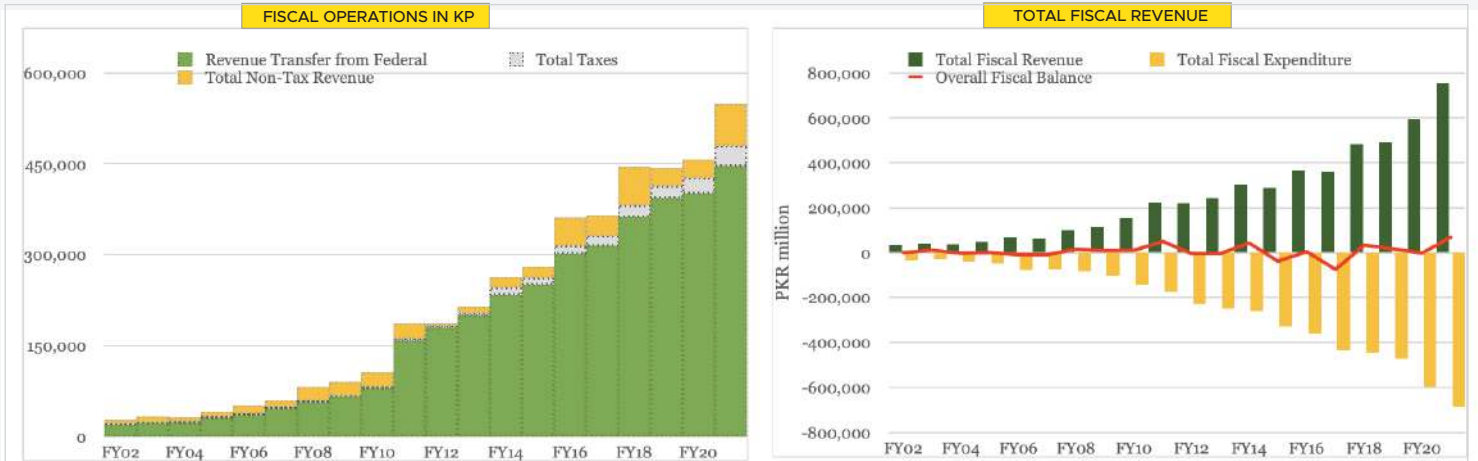


FIGURE 4: FISCAL OPERATIONS IN KP PROVINCE

At a time when inflationary cost pressures on businesses are mounting, vulnerable KP businesses may require fiscal support to sustain their growth levels or to protect businesses from slipping. The current fiscal position of the KP economy shows that the province had a positive fiscal balance in FY21 (Fig 4) with development expenditure (as a share of total expenditure) decreasing from 32 per cent in 2017 to 28 per cent in 2021. The KP government should support the development sector and if grants and transfers from the federal government remain at current levels, there is space for the KP government to strategically support SMEs and cottage industries that need it the most.

ROUNDTABLE DISCUSSIONS

The Pre-Budget consultative session was attended by over 20 participants, who represent a wide range of business sectors with significant contribution to the province’s economy and its growth (Fig 5). From SEED’s quarterly Business Barometer Surveys, it is evident that as little as five per cent businesses feel heard in the policymaking chambers of the federal and provincial governments. The purpose of this roundtable was not only to attempt to bridge this gap but also to consolidate recommendations from across the spectrum of the diverse private sector in the province and deliver it to the policymakers in time for the budget 2023.

5%

BUSINESSES IN ROUND 3 FELT THEIR VOICES ARE BEING HEARD IN THE FEDERAL AND PROVINCIAL POWER CHAMBERS




REPRESENTATIVE GROUP	RATIONALE FOR INCLUSION
PRESIDENTS OF CHAMBERS SUCH AS SARHAD, HATTAR, GADOON, WOMEN CHAMBERS	ORGANIZED BUSINESS ASSOCIATIONS AND CHAMBERS REPRESENT THE VOICE OF THEIR MEMBERS AND PLAY A CRITICAL ROLE IN INFORMING POLICYMAKERS ON THE IMPACT OF BUDGETARY MEASURES ON BUSINESSES AT LARGE. THE INVITED CHAMBERS ARE ACTIVELY INVOLVED WITH THE KP GOVERNMENT DURING THE BUDGET-MAKING EXERCISE AND SEND THEIR RECOMMENDATIONS TO THE RELEVANT MINISTRIES FOR CONSIDERATION
MANUFACTURING SECTOR	MAINLY CONSTITUTING OF SMES WITH GREATER SHARE OF FEDERAL-LEVEL FORMALITY (IN TERMS OF BEING TAX COMPLIANT), THE MANUFACTURING SECTOR IS GREATLY AFFECTED BY TAX-RELATED CHANGES, BOTH FEDERAL AND PROVINCIAL
SERVICES SECTOR	THIS INCLUDES TRADING (ESPECIALLY CROSS-BORDER TRADE WITH AFGHANISTAN), TOURISM, HEALTH, EDUCATION, HOSPITALITY, FINANCIAL SERVICES, AND IT WHICH ARE ALSO STRONG GROWING SECTORS OF THE ECONOMY
MINERAL SECTOR	SIGNIFICANT CONTRIBUTION TO KP ECONOMY AND LARGE ENTERPRISE BASE IN KP

FIGURE 5: PRE-BUDGET ROUNDTABLE SECTORAL PARTICIPATION

The participants highlighted the following major areas which affect the business environment in KP and required policy interventions from the provincial as well as the federal government. Detailed recommendations are provided in the next section.

TAX ADMINISTRATION

Pakistan's economy is characterized by a narrow tax base with fairly high tax rates. The limited ability of the revenue authorities, particularly the Federal Board of Revenue (FBR) to mobilize tax revenues by expanding the tax net disproportionately burdens existing taxpayers. Participants noted that the cumbersome and costly tax collection process is a deterrent to becoming part of the formal economy and remaining within the system.

- Once registered, taxpayers reported predatory treatment by tax officials. Businesses report that they have to face frequent and unnecessary tax audits. While there is no cost to the auditor of such behavior, he or she in fact stands to gain personally by closing the case with an informal/side payment. On the other hand, the business incurs heavy costs in the form of monetary payments and court cases, compared to settling informally.
- In the case of withholding tax audits, tax authorities demand business records dating back to many years which are not accessible to the businesses themselves and become a major problem in declaration and filing.
- Another reported deterrent to registering business was that Khyber Pakhtunkhwa Revenue Authority (KPRRA) asks first time filers to pay retroactive provincial taxes from the time KPRRA was established rather than the time of registration.
- Taxpayers are often not told about documentation requirements in time. This asymmetry in information results in delayed/inadequate filing or non-filing. The same applies to changes in tax laws and codes as well, which are subject to change without notice.
- The process of paying and filing taxes is believed to be difficult, time-consuming and costly, especially for small businesses who have to hire specialized tax accountants and lawyers which adds to their cost of business. Women entrepreneurs highlighted that the tax payment and filing system was too daunting for them, dissuading them from registering.

The participants recommended that revenue authorities ought to focus on bringing more income streams into the tax net and introducing punitive measures for non-taxpayers rather than penalizing existing taxpayers through rent-seeking and over-taxation. In addition, information gaps must be removed for new and existing taxpayers, and a simplified system of tax filing must be introduced to reduce time and cost burdens.

HIGH AND PROHIBITIVE TAX INCIDENCE



- **PROPERTY TAXES:** Aside from paying property and excise taxes on property rented to a commercial entity, participants reported, an additional cess is also required, which was excessive and akin to tax duplication. In addition, businesses leasing land from KP Economic Zones Development and Management Company (KPEZDMC) have to pay property taxes in addition to charges to KPEZDMC. They feel that charges to KPEZDMC are in lieu of the services and development provided and therefore are a duplication since property taxes are already paid. Given the security climate of the province during the 2005-18 period, the federal government had granted exemption on property taxes to industries and offered a tax and markup relief for three years which was a beneficial step. *It was recommended that tax duplication should be eliminated.*
- **WITHHOLDING TAXES:** The FBR has increasingly been relying on withholding taxes on income and consumption. Today FBR collects 70 per cent of its direct taxes from withholding measures. The burden of collecting these withholding taxes falls on withholding agents (typically businesses) that act as proxy to the tax collector without any benefit to their own business. Roundtable participants strongly opposed withholding taxes which they perceive to be “regressive”. *It was recommended that FBR focus on reforms to mobilize direct taxation measures and not transfer the responsibility of collecting taxes to withholding agents. Businesses acting as withholding agents have to not only collect these taxes but also fulfill heavy reporting requirements which adds to their costs. At the outset, these need to be simplified.*
- **TAXES FOR WOMEN-OWNED BUSINESSES:** Participants highlighted that FBR has offered reduced tax rates of 25 per cent for 100 per cent women- owned businesses, which is a good step. However, these rates need to be more flexible, so that businesses with majority shareholding of women could qualify. Women-owned businesses hardly make up eight per cent of the total share in the economy; while other women-run businesses are registered in the name of or majorly owned by their male family members. *It was recommended that the reduction in tax rates should apply to women-owned businesses with majority shareholding and not just 100 per cent ownership.*
- **FEDERAL/PROVINCIAL COORDINATION:** Businesses argued that provincial revenue authority and FBR should be aligned on tax rates and input adjustments. The double burden of reporting to both KPRA and FBR, for instance, is a hassle. *It was recommended that since all the data is digitized, tax authorities should share information/systems to facilitate taxpaying businesses.*
- **OTHER TAX IRREGULARITIES:** It was highlighted that the previous provincial and federal budgets proposed reduction of the annual financial turnover rate for taxation, but these were yet to be notified, one year on. Participants noted that cottage industries were exempted from sales tax; however, the sellers of cottage industry products were still liable to tax, showing that notified tax exemptions have not been effectively implemented. *Such inconsistencies should be resolved.*
- **IMPORT TARIFFS:** In general, import tariffs compared to regional countries are higher which need to be brought at par. It was also highlighted that import duties on certain items, prone to smuggling through Afghan Trade Transit, should be decreased to encourage formal trade while custom duties for raw materials reduced to support local industry competitiveness. *Specifically, it was recommended that advance income tax on raw materials should be reduced from 5.5 per cent to three per cent while the additional sales tax of three per cent on raw materials should be removed.*

INVESTMENT CLIMATE



Apart from tax measures, the roundtable also made recommendations about the investment climate. Participants noted that under the Pakistan Regulatory Modernization Initiative, also called the Asaan Karobar Program, as many as 115 reforms have been introduced across 75 government departments targeting 31 business sectors. Businesses during the roundtable, however, contended that the impact of this reform program was not yet visible in their day-to-day business.

A major challenge highlighted was the lack of policy stability. It was argued that the government has been in a perpetual firefighting mode. A side-effect of that has been sudden and frequent announcements and withdrawals of policies, sometimes before they could even be fully implemented. This policy behavior is not conducive to attracting new and large investments and increased risk premium for investors looking for secure and profitable avenues.

Participants also called for decriminalizing genuine business failure and bankruptcy. They argued that true entrepreneurs experimenting with a new economic activity have high failure rates across the world, but with the highest learning. New economic activity also allows for economic diversification. The government must allow businesses to fail without ascribing criminal intent and allow them to get back up again. There needs to be a policy to revive sick industries, and incentives should be given to start-ups so they can combat their high information costs. New funding avenues are also needed for start-ups.

Businesses also felt that where KP has a disadvantage – such as higher transport costs to ports - there is no policy to compensate them but wherever there is an advantage - for instance, adequate supply of gas and hydel - KP is expected to compromise for the sake of national interest. Businesses felt that this was unfair and inconsistent. For instance, KP produces electricity at an average of Rs 2 which the federal government sells back to the province at Rs18. And the cost is expected to rise further. ***Wheeling of electricity to KP should, thus, be the top priority.***

Participants highlighted that while there have been improvements in moving money across borders, the process remains onerous. Firms, especially in the IT sector, are fairly mobile, and will prefer registering abroad in less problematic regions, and will only move back enough money to pay salaries. Currently, many businesses and entrepreneurs who earn in foreign currencies find it much easier to not bring money to the country. It is recommended that obstacles in mobility of money should be removed, and the government should incentivize businesses to reinvest in Pakistan.

A strong investment climate requires government facilitation in other forms such as Research and Development (R&D) centers. Especially, in sectors ***such as mining which are crucial for KP's economy, investment in R&D and research centers connected to the industry is vital for growth.***

It was further highlighted that skilled labor remains a severe problem in KP, especially for the booming IT sector. ***Skills training programs for the province are needed, but they should be targeted, catering to the specific skillset needed by the industry.***

Private sector participation in the healthcare infrastructure is vital for the expansion of healthcare services in the province. Participants agreed the Sehat Card should continue. However, they insisted that the programme should be made robust and financially viable before expanding it further, e.g., to outpatients. They also noted other areas requiring attention such as ***the disincentive for the private sector to compete as rates were not rationalized, leading to poor quality service (to match the reimbursable levels). In the current structure, the government pays for the outcome, not the infrastructure and there is no incentive for anyone to invest in hospitals and healthcare infrastructure. Participants suggested that this initiative be connected to the Khyber Pakhtunkhwa Employees Social Security Institution (KP ESSI) system and that the program focus on strengthening primary healthcare, rather than tertiary.***



RECOMMENDATIONS TO THE KP GOVERNMENT



Based on the stakeholder consultation, the recommendations presented below are aimed at addressing general economic challenges; KP specific cost factors: improve tax administration and simplification of taxation system to broaden the tax net; improvement in documentation; lower the cost of tax compliance; improve the businesses competitiveness, and incentivize specific businesses.

LOWER THE COSTS TO ENHANCE COMPETITIVENESS

To counter shrinking fiscal space and other disadvantages, the government could consider reducing energy costs; providing mark-up subsidies on loans; and undertaking supportive provincial tax measures as well as transport subsidies. These will help shield businesses from rising inflation and cost burdens.




AREA OF INTERVENTION	MEASURE	OUTCOME
ELECTRICITY 	ALLOW INEXPENSIVE ELECTRICITY TO INDUSTRIAL CONSUMERS VIA WHEELING ARRANGEMENTS IN ADDITION, SUPPORT FOR ADOPTING RENEWABLE ENERGY (SUCH AS SOLAR ROOF PANELS) OR ENERGY CONSERVATION EQUIPMENT CAN AID IN COST REDUCTION WHILE BEING CLIMATE FRIENDLY	COST REDUCTION
ACCESS TO FINANCE 	ALLOW SUBSIDIZED WORKING CAPITAL FINANCE FOR BUSINESSES, SIMILAR TO THE COVID-RELIEF PACKAGE CLEAN LENDING SCHEMES, REDUCED COLLATERAL REQUIREMENTS AND/ OR GUARANTEE SCHEMES CAN ALSO BE DESIGNED ALONG THE LINES OF SIMILAR SCHEMES INTRODUCED BY SBP; SOME OF THESE CAN ALSO BE OFFERED IN PARTNERSHIP WITH SBP, WHERE THE KP GOVERNMENT IS A GUARANTOR	CASH FLOW AND LIQUIDITY MAINTENANCE, PARTICULAR FOR UNDER-COLLATERALIZED SMES
TRANSPORT 	SUBSIDIZED TRANSPORTATION FOR PROVINCIAL GOODS	COST REDUCTION

FIGURE 6: RECOMMENDATIONS TO MINIMIZE COST BURDEN

EXPANSION OF THE PROVINCIAL TAX NET AND IMPROVING TAX ADMINISTRATION

The KP government has a small tax base as it collects insufficient tax revenues, mainly due to high levels of informality. To address this, the government should make it easy for businesses to pay and file taxes; harmonize the provincial and federal systems; remove tax irregularities and duplication - all this will motivate businesses to become tax compliant. The KP government should develop a system of taxation that benefits existing taxpayers instead of penalizing them, while taking stronger measures to bring non-taxpayers into the tax net.

In this regard, the following interventions are suggested:








AREA OF INTERVENTION	MEASURE	OUTCOME
TAX FILING 	EXEMPT NEW PROVINCIAL TAX FILERS FROM PAYING RETROACTIVE RETURNS	INCREASE IN TAX COMPLIANCE
FILER/NON-FILER 	INCENTIVIZED FILERS THROUGH ACCESS TO POTENTIAL SCHEMES FOR COST REDUCTION AND COMPETITIVENESS SUCH AS WHEELING ARRANGEMENTS AND/OR SUBSIDIZED CREDIT AND OFFERING	ENCOURAGE DOCUMENTATION
TAX ADMINISTRATION 	<ul style="list-style-type: none"> ▀ REDUCE TAX PROCESSING TIMES ▀ PROVIDE TAX PAYMENT AND FILING TRAININGS AND REMOVE INFORMATION GAPS. ENSURE CHANGES IN TAX CODES AND LAWS ARE COMMUNICATED QUICKLY. THIS SHOULD BE SPECIALLY TARGETED TO SMES AND WOMEN BUSINESSES ▀ ALL TAX PAYMENTS AND DOCUMENTARY REQUIREMENTS SHOULD BE DIGITIZED AND AVAILABLE ON ONE PLATFORM (IRIS) AND THE DUAL SYSTEM FOR KPRA AND FBR SHOULD BE REMOVED 	INCREASE IN TAX COMPLIANCE
REGULATIONS 	<ul style="list-style-type: none"> ▀ UNNECESSARY REGULATIONS SHOULD BE REMOVED. FOR EXAMPLE: ONCE BUSINESSES START OPERATING IN RENTED BUSINESSES AND ARE REGISTERED WITH THE TAX AUTHORITY, THE REQUIREMENT OR USE OF UTILITY BILLS AS PROOF SHOULD BE REMOVED ▀ ONE-WINDOW FACILITY FOR ALL REGISTRATION AND LICENSING REQUIREMENTS FOR BUSINESSES SHOULD BE INTRODUCED 	INCREASE IN TAX COMPLIANCE
TAX AUDITS 	<ul style="list-style-type: none"> ▀ HARASSMENT AND DISCRETIONARY POWERS OF TAX COLLECTING OFFICIALS SHOULD BE ELIMINATED BY INTRODUCING A SYSTEM WITH LITTLE TO NO DIRECT CONTACT BETWEEN OFFICIALS AND TAXPAYERS ▀ TAX INCENTIVES FOR OFFICERS SHOULD BE REALIGNED ▀ INCENTIVIZE BUSINESSES TO REPORT HIGHER INCOME THROUGH EXEMPTIONS FROM AUDITS. FOR EXAMPLE, IF A BUSINESS REPORTS 25 PER CENT OR MORE GROWTH IN TAXABLE REVENUES IN A YEAR, IT SHOULD BE EXEMPTED FROM AUDIT ON GST 	INCREASE IN TAX COMPLIANCE

FIGURE 7: RECOMMENDATIONS TO IMPROVE TAX ADMINISTRATION AND WIDEN THE TAX NET

LEVERAGING KP'S GEOGRAPHIC LOCATION

KP enjoys the advantage of being located at the apex of Pakistan's North-South economic corridor connecting Pakistan's economy to Afghanistan and beyond to Central Asia and China. Afghanistan and Pakistan are natural trading partners with high complementarities in goods and services trade. Currently, KP has a competitive disadvantage with access to other markets because it is farther from the sea ports, but the province has a competitive advantage in Afghanistan and Central Asia. This needs to be a national priority. The KP government should strongly advocate for improving ties and trade relationships with Afghanistan, while removing barriers to trade with Afghanistan. Strengthening the local economy in Khyber Pakhtunkhwa directly impacts the potential for revenue collection.

It is expressed that the KP government focus on the following:

¹ THE MATCHING OF ONE COUNTRY'S IMPORTS WITH THE OTHER COUNTRY'S EXPORTS ALLOWING FOR HIGHER TRADE





AREA OF INTERVENTION	MEASURE	OUTCOME
<p>ELIMINATE TRADE HURDLES</p> 	<ul style="list-style-type: none"> ▶ ELIMINATE BURDENSOME TRADE CONTROLS AND BORDER RESTRICTIONS THAT HINDER TRADE TIES ▶ INVEST IN TECHNOLOGY AT THE BORDER FOR LOGISTICAL EFFICIENCY ▶ SET UP EFFECTIVE DISPUTE RESOLUTION MECHANISMS AT THE BORDER TO QUICKLY RESOLVE ISSUES AT BORDER SITES ▶ BRING THE PRIVATE SECTOR ON BOARD TO IMPROVE COST-EFFECTIVE TRANSPORT INFRASTRUCTURE 	<p>INCREASE IN TAX COMPLIANCE</p>
<p>TRANSIT AGREEMENT</p> 	<p>THE KP GOVERNMENT SHOULD WORK WITH THE MINISTRY OF COMMERCE TO GET THE AFGHAN PAKISTAN TRANSIT TRADE DEAL APPROVED AND EXPEDITED. THE AGREEMENT SHOULD FOCUS ON:</p> <ul style="list-style-type: none"> ▶ COST-EFFECTIVENESS OF THE ROUTE ▶ BORDER VIGILANCE ▶ FULL ENFORCEMENT ON BOTH SIDES ▶ ANTI-SMUGGLING MEASURES THAT DO NOT INCREASE REGULATORY BURDEN 	<p>EXPAND CROSS-BORDER AND TRANSIT TRADE</p>
<p>STAKEHOLDER ENGAGEMENT</p> 	<p>A PERMANENT PROBLEM-SOLVING COMMITTEE MUST BE ESTABLISHED COMPRISING VARIOUS FEDERAL AND PROVINCIAL GOVERNMENT OFFICIALS TO RESOLVE OPERATIONAL ISSUES FACING TRADERS AND BUSINESSES.</p>	<p>FACILITATE TRADERS AND ELIMINATE TRADE HURDLES QUICKLY</p>

FIGURE 8: RECOMMENDATIONS TO LEVERAGE KP'S GEOGRAPHICAL POSITION

GROWTH-ENHANCING TAX AND NON-TAX MEASURES

Though tax exemptions or tax benefits are seen as foregone revenue for the exchequer, they facilitate businesses by reducing their business costs, improve their competitiveness in the domestic and international markets and aid in new investments, ultimately leading to growth.

Participants suggested the KP government consider the following tax and non-tax measures and reliefs to enhance growth in productive sectors:

AREA OF INTERVENTION	MEASURE	OUTCOME
<p>HOSPITALITY</p> 	<p>KP HAS A COMPARATIVE ADVANTAGE IN HOSPITALITY AND TOURISM WHICH THE PROVINCIAL GOVERNMENT SHOULD LEVERAGE. SME BUSINESSES IN THE SECTOR USUALLY OPERATE INFORMALLY. THUS, TO INCENTIVIZE DOCUMENTATION, LOWER GST SHOULD BE CHARGED ON DIGITAL TRANSACTIONS, AS IN PUNJAB, TO FACILITATE THE SECTOR. HOWEVER, INPUT-OUTPUT ADJUSTMENTS FOR THE SAME WOULD HAVE TO BE MANAGED HERE.</p> <p>FOR THOSE BUSINESSES RECORDING INCREMENTAL REVENUES (BEYOND CERTAIN THRESHOLDS SUCH AS GROWTH OVER 25 PER CENT) WOULD BE PREFERRED IN GOVERNMENT EMPLOYEES TRAINING PROGRAMMES AND TO BE PRIORITIZED IN OFFERING CONCESSIONARY FINANCE SCHEMES</p>	<p>BOOST GROWTH AMONG SMALL AND MEDIUM HOSPITALITY BUSINESSES AND ENHANCE DOCUMENTATION</p>







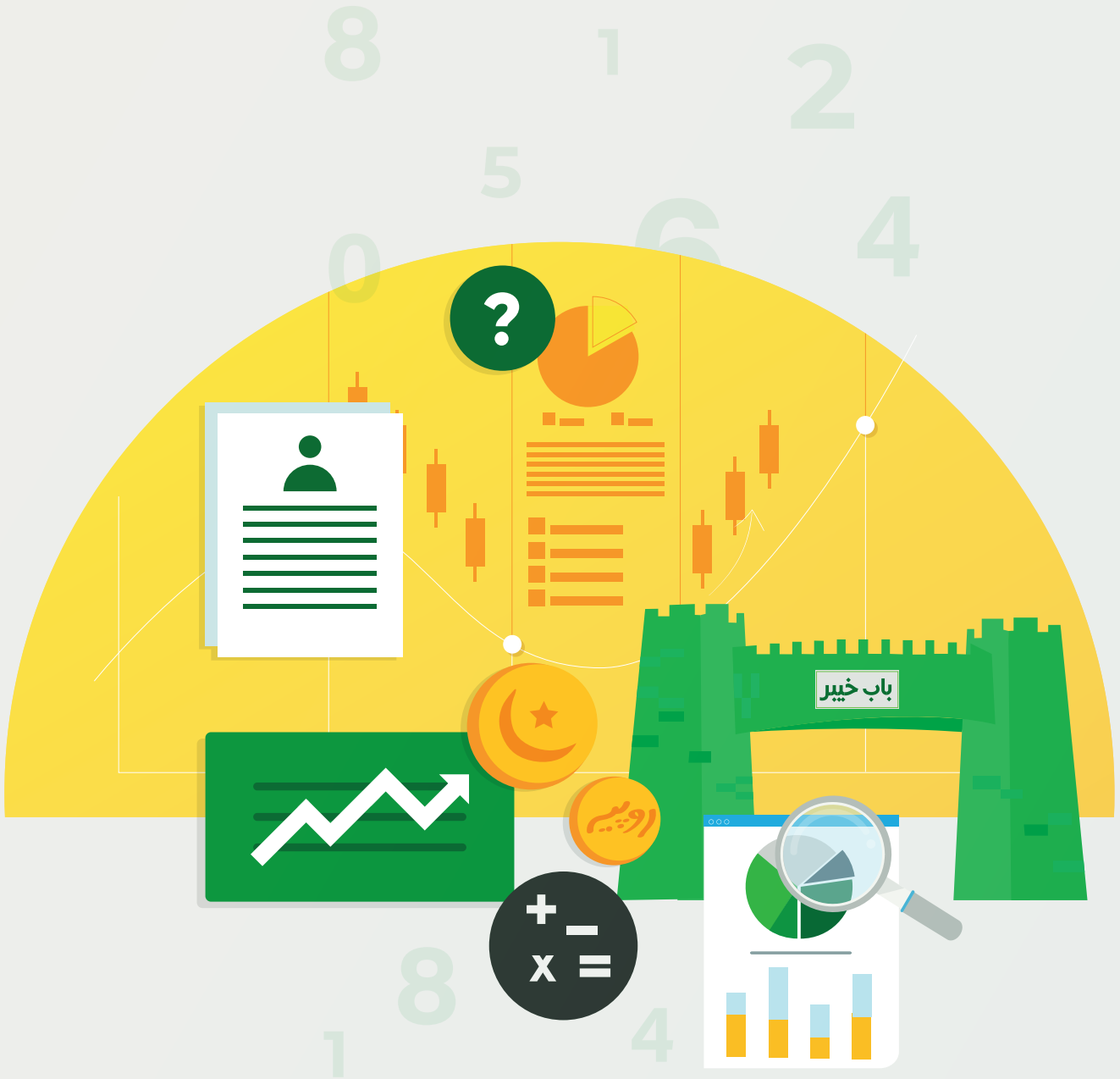
AREA OF INTERVENTION	MEASURE	OUTCOME
DIGITIZATION AND IT 	<ul style="list-style-type: none"> ➤ REDUCTION IN TAX ON DATA AND DIGITAL FINANCIAL TRANSACTIONS ➤ PROVIDE INCENTIVES TO INCREASE INVESTMENT IN IT AND TELCO INFRASTRUCTURE ➤ RESOURCES AND PROGRAMS FOR THE EDUCATION AND SKILLS TRAINING OF PERSONNEL FOR THE IT SECTOR 	<p>MOBILIZE DIGITAL FINANCIAL SERVICES IN KP, WHICH WILL ULTIMATELY ENHANCE DOCUMENTATION</p> <p>CAPITALIZE ON THE POTENTIAL OF THE BOOMING IT SECTOR IN PAKISTAN</p>
WOMEN-OWNED BUSINESSES AND STARTUPS 	<ul style="list-style-type: none"> ➤ TAX INCENTIVES FOR BUSINESSES WHICH HIRE WOMEN ➤ TAX INCENTIVES FOR START-UPS ➤ INCENTIVES ON PROCUREMENT POLICIES OF CONTRACTORS/ SUB-CONTRACTORS WORKING WITH WOMEN-OWNED BUSINESSES ➤ CREATE A TAX-EXEMPT NBFC (NON BANK FINANCIAL COMPANY) TO PROVIDE FINANCIAL PRODUCTS TO START-UPS SUCH AS EQUITY FINANCE AND VENTURE CAPITAL. 	<p>INCREASE IN ENTREPRENEURSHIP, AND GROWTH IN WOMEN-MAJORITY OWNED BUSINESSES</p>
ELECTRICITY 	<p>WHEELING OF ELECTRICITY TO KP NEEDS TO BE PRIORITIZED TO ALL INDUSTRIES</p>	<p>REDUCE COST OF BUSINESS</p>
HEALTHCARE INFRASTRUCTURE 	<p>SEHAT CARD SHOULD BE CONTINUED AND RATES SHOULD BE RATIONALIZED TO MAINTAIN QUALITY OF HEALTHCARE SERVICE AND INCENTIVIZE PRIVATE SECTOR PARTICIPATION AND INVESTMENT</p>	<p>ENHANCE INVESTMENTS AND PROVIDE SOCIAL PROTECTION TO KP POPULATION</p>
POLICY STABILITY 	<p>A CHARTER OF ECONOMY MUST BE ESTABLISHED WITH BUY-IN FROM PROVINCIAL AND FEDERAL GOVERNMENTS TO SHAPE FUTURE POLICY AND ENSURE STABILITY</p>	<p>ENHANCE INVESTMENTS</p>
TELCOs 	<p>THE KP GOVERNMENT NEEDS TO DEVELOP A LONG-TERM PLAN TO ATTRACT AND SUPPORT INVESTMENT IN TELCO-INFRASTRUCTURE AND MAKE IT FINANCIALLY VIABLE FOR TELCOS TO INVEST IN KP</p> <p>THERE IS NO TIER 1 CITY IN THE KP WHICH MEANS THAT KP'S CITIES ARE THE LAST TO GET IT INFRASTRUCTURE AND UPGRADES SUCH AS 5G. THE KP GOVERNMENT SHOULD SUPPORT THIS INVESTMENT THROUGH REDUCTION/ELIMINATION OF TAXES TO MAKE IT FINANCIALLY VIABLE FOR TELCOS TO INVEST IN KP</p>	<p>INCREASE INVESTMENT FREEDOM</p>

FIGURE 9: RECOMMENDATIONS TO INTRODUCE PRO-GROWTH TAX AND REFORM MEASURES

HARNESSING KP'S TAX POTENTIAL

Though KP's revenue does exceed its expenditure, the development expenditure has been moving downwards, and the province primarily relies on federal transfers and grants to meet its expenses. This indicates a dire need to focus on mobilizing provincial tax revenue. By doing that, KP would be able to spend more on development projects as well as provide fiscal support to businesses in need. The focus should be on three streams of taxation: property, land taxes and agriculture income taxes. The KP government has been working on rationalization of sales tax on services and introducing reforms to mobilize Urban Immovable Property Tax. After the 18th Constitutional Amendment, provinces have the powers to levy progressive taxes such as wealth tax on immovable property, inheritance and gift tax and KP needs to move towards these for their immense tax potential.





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