

Note on the First Meeting of the Prime Minster's Task Force on the Economy

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Note on the First Meeting of the Prime Minister's Task Force on the Economy

Tariq Banuri

The following is an outsider's impression of the task force meeting. The major area of concern is that long term consequences of actions were relatively neglected during the discussions. This goes against the grain of the terms of reference of the group, namely to identify not only short run actions, but also immediate steps that need to be taken to initiate a long run process of reform. My view is that most of these cases fall into a single category, in which the past mismanagement has led to the creation of real or perceived **property rights**. As a result, attempts to rationalize the structure will lead to resistance, since it deprives people of some property; examples are imposition of WAPDA tariffs on tubewells, imposition of agriculture income tax, and even the resistance of some provinces to WAPDA's privatization. In this case, the political problem cannot be ignored or bulldozed over. The correct economic solution is to buy out the property rights from the individuals or institutions.

In addition to this, some assumptions need to be questioned. Below are a few specific examples of both the above problems.

WAPDA's tariffs

The World Bank insists on tariff increases to improve efficiency and mobilize investment resources. The argument is that the current system gives incentives neither for conservation nor efficiency improvement. Consumption in the household and farm sectors is heavily subsidized (and the latter divorced from price signals), the multitude of rates give confusing signals, and the utility is given no incentives to meet its resource requirements or improve efficiency. Unfortunately, while the recommendations will certainly result in price increase, they will not achieve the desired objectives.

To begin with, WAPDA's calculations are not quite transparent. The argument that the household sector is paying less than marginal costs seems somewhat flimsy. On the basis of figures, the true average revenue works out to about Rs. 0.90, and not Rs. 1.26 per unit. Cost figures were not provided, but the true average cost can be calculated as Rs. 0.90 minus the net surplus per unit. This means that the household sector, which pays Rs. 0.86 per unit, is being charged close to the average cost. The basis for marginal cost figures was not provided, even though a figure of Rs. 1.20 was mentioned. This needs to be examined. In general, high cost industries (such as utilities), exhibit marginal costs lower than average cost. If WAPDA suggests otherwise, their figures and assumptions would have to be examined carefully to determine the reasons for the divergence. It is possible that they base these figures also on 23 per cent leakage's.

Given the above, the case for increasing the tariff is not clear at all. Indeed, since an increase in rates might lead to increased leakage, the revenue implications too are not entirely clear.

The case becomes murkier when it is realised that nothing is being planned for the three problems affecting both efficiency and conservation: the flat rate on tubewells, the problem of leakage and proliferation of rates. Perhaps these are not amenable to short run or precipitate action, but the mandate of the task force also extends to identifying immediate actions that will lead to long range desired outcomes. Nothing of this sort seems to be in works. There does not

appear to be a clear vision of future reform, except pious exhortation. No plan was proposed on how to get WAPDA to respond to efficiency concerns. There is no game plan for leakage plugging, and none for shifting towards proper pricing for tubewells. In other words, only the price will increase, and the incentive system will continue to reward inefficiency and incompetence.

An alternative plan might include the following:

1. To reduce the proliferation of rates, combine the existing rates to
 - a. three slabs for households (0-50, 51-300, and 301 and above), consolidated in such a way that the lowest slab does not get affected unduly;
 - b. a combined slab for commercial, industrial (except for different quality of service), and agricultural users.
2. Realising that the tubewell issue is that farmers have acquired quasi-property rights on electricity, the rationalisation process will involve the purchase of these rights. One formula for the purchase of these rights would be to convert them into collective rights and hand them to the local community (such as a village organisation or local council). This could be done by announcing a formula, such as the following:
 - a. Announce that the benefits being given to the farmers will be converted into cash (these are equal to actual meter charge minus the flat rate).
 - b. This cash amount will be treated as grant in aid to the Union Council or Village Organisation or any other collective body.
 - c. The collective body can use this grant either to pay off the dues of the tubewell holders, or to undertake any infrastructure investment of its choice.
 - d. If the collective body uses it to pay off the dues of its members, then the amount will be simply a book transaction. However, since the cash amount has been fixed in nominal terms, any future increase in tariffs will increase the liabilities of the farmers.
 - e. If the collective body wishes to use the amount for development purpose, it will be authorised to collect it directly from farmers as land revenue. The transaction between WAPDA and the collective body will continue to be a book transaction.
 - f. WAPDA would be willing to provide technical assistance for such investment--it may include investment in alternative energy resources, such as solar, wind power, micro hydel, or waste recycling or biogas.
3. WAPDA should be asked to submit a plan within a fixed period of time (say one month) for reducing leakage's. This might include an educational campaign, a system of assigning rights to local communities, or others. The point of the latter suggestion is to provide incentives to civil society to cooperate with the utility in raising the price of the resource to its social cost.

Tightening the tax net

The idea that sending a few tax defaulters to jail will resolve the problem of tax evasion is not very sound. This can be called a "Cleanliness Week (*hafta-e-safai*)" view of the world, the view that a small set of symbolic actions will overcome the impact of a history of neglect and corruption. The country is so used to such unsustainable, unsustainable and ultimately ineffective campaigns that another one will only lead to cynicism and resistance. In addition, much of the tax machinery is reputed to be corrupt and inefficient; therefore, raising the ante in this way (by increasing the probability of punishment) will simply increase the leverage of the tax inspector over the taxpayer. This may not be what the government intends. In general, a selectively applied law generates resistance, leads to lobbying and rent seeking, and to cynicism. It does not matter whether the selectivity is for political reasons, departmental corruption, or simply the decision by the government to go slow on the change. It will further add to the feeling of injustice that is already very pervasive in our society.

It may be better to work on three fronts. Give clear notice and publicity of intent to prosecute. Keep the magnitude of punishment small in the initial years; if necessary, increase it subsequently. Combine these with a programme of tax system reform for improving the conditions of work of tax officers, in order to reduce the incentives for corruption.

Privatisation

The issue of privatisation of loss making units was discussed very briefly. Here, the main concern is with regard to the transparency and integrity of decision making. If the government does not expect to make a great deal of money from these outfits, the best thing to do is to throw open the books, reports, analyses and background documents for public scrutiny. This may be far more important than deciding whether or when to privatise. The actual act has not become inconsequential, the main issue is its legitimacy. Energies should be focused on ensuring the latter. This can only be done through an open public scrutiny.

On the use of proceeds from privatisation, the proposal that this should be used only to retire debt (i.e. as portfolio adjustment) and not for financing current consumption is a good one. However, the fundability of public monies is so well known that this provision may be violated quite easily. It may be important to discuss how other public institutions (judiciary, mass media, auditors, state bank, researchers) could be involved in monitoring this decision.

Agricultural income tax

Once again, the farmers have acquired quasi-property rights in public resources without the payment of **direct** taxes. In order to change the system, it is necessary that these rights be "purchased" in some manner from the farmers. The start is to put a figure on the right, in other words to do an exercise that would define clearly the amount that is implicitly being given as grant in aid. The second is to create a vested interest among themselves for tapping into this amount. The two can be accomplished by linking agricultural income tax with local government. If provincial governments can levy the tax but ask the local councils to collect it as well as use it for a given set of purposes (education, health, hygiene), the local community might view the tax as more legitimate, the government would find partners within each community in its insistence on collecting the revenue and spending it wisely.

Women

A very simple reform that would go in the direction of raising the status of women, is to give a clear preference to women in the hiring of school teachers. Only if a qualified woman is not available (i.e. does not answer the ad) should a man be appointed to a teaching position in primary or secondary schools. To complement this, the government may also wish to entrust the management of schools to Mothers' Committees. This would remove fears of male domination of women teachers, and provide respectability to a role that has historically performed by women in our (and other societies) namely educating our children.