SPdC

RATIONALIZATION
OF
OCTROI RATES

SOCIAL POLICY AND DEVELOPMENT CENTRE

RATIONALIZATION
OF
OCTROI RATES

By

Aisha Ghaus-Pasha
Rauf Khan
Naveed Hanif

1994

Social Policy and Development Centre

RATIONALIZATION OF OCTROI RATES

RATIONALISATION OF OCTROI RATES

EXECUTIVE SUMMARY

The Octroi tax is the largest single source of revenue of local governments. It is imposed on goods imported into the municipal limits for local use, sale or consumption and is generally collected by private contractors. Octroi is a specific charge on the basis of weight and varies across commodities. These rates are low and have remained unchanged for the ten years ending 1991.

The study uses a sample of urban councils for analysis. The sample ensures representation by province and status. The sample includes 2 metropolitan and 8 municipal corporations, and 8 municipal and 2 town committees.

The study quantifies the commodity-wise variation in octroi rates and identifies factors which explain this variation. Five groups of commodities were selected, namely, food and drinks; consumer durables; raw materials/intermediate goods; capital goods; and other goods. A total of 115 commodities were selected. 26 commodities were articles of food and drinks; 8 were lighting and fuel; 2 were animal and animal products, 9 were building materials; 6 were items of furniture and fixtures and 13 were articles of clothing etc.

Although, the commodity schedule has been standardised, rates vary from city to city. There does not appear to be any systemic pattern of variation in rates with some several cities showing significantly higher rates for some commodities and substantially lower rates for other commodities. The high variation in octroi rates across cities includes articles for lighting and fuel; drinking, smoking and chewing; clearning and washing; clothing and metals and machinery. It appears that across cities in the variation in rates on food items is lesser than the rates on non-food items. The variation in octroi rates across cities by status is also observed. The results show that there is a greater variation in rates among urban areas with the status of a town committee than among the larger ones.

Effective octroi rate (EOR) was derived for each city as the ratio of the flat rate octroi to the price of the commodity. The analysis of commodity-wise variation shows that about 43 percent are charged at the lowest rates ranging from 0 percent to 0.1 percent of the value of goods, another 44 percent are charged at rates between 0.11 percent and 0.30 percent. Only about one percent of the commodities are charged at rates over 0.30 percent. For consumer goods, the effective rate has been derived with respect to retail price while in the case of raw materials, intermediate goods and capital goods wholesale prices were used. Commodity groups with the lowest octroi rates were other consumer goods and consumer durables with the average EOR of 0.25 percent and 0.26 percent respectively. Food and drinks were among the highest octroi rate category alongwith capital goods and intermediate goods, with average EOR of about 35 percent to 36 percent. Therefore, there are massive fiscal anomalies in the existing octroi structure. Commodities which were of a basic good nature have the highest rate while luxury consumer goods have the lowest tax burden.

The dependence of octroi revenues from land dues on basic commodities like foods, textiles, drugs, medicines, building material, etc.. implies that the incidence of this component of octroi is likely to be fairly regressive in character. This would tend to suggest that the buoyancy of revenues may he low because of the relatively slow growth in demand for food, textiles, etc.

The methodology for proposing tax rate changes proceeds first by setting up criteria on the basis of which different commodity groups can he ranked in terms of the 'desired' level of octroi rate. This is followed by an analysis of the desired with the actual rate. Only if this difference is significant does the commodity become a candidate for rate change. However, to preserve revenue neutrality (that is no additional revenue gain) it was ensured that the overall average effective tax rate remains unchanged. Several constraints were also imposed. As a general rule, the rate of taxation on basic consumer goods, especially food items, has been kept low as any associated increase in prices is likely to hit the poorer households more. Next, it was also felt desirable to keep the rates on capital goods as low as possible so as to encourage investment in the regional economy on the grounds that this investment contributes to an enhancement in the size of the tax base.

In the case of intermediate goods which arc processed by industry within the metropolitan/ municipal limits there is a greater probability that the burden will fall on capital income accruing to owners and share holders of industrial equity. The burden, as such, is likely to he more progressive. Given the nature of the good, the next criterion relates to its incidence by income groups. This can be identified directly in the case of consumer goods given the prevailing expenditure patterns of households in the urban areas. An analysis of the recent data on national imports and the income elasticity of demand the different commodities were ranked in terms of the buoyancy of import demand. This criterion implies that, other things being equal, higher octroi rates should be specified on those commodities which have a relatively price inelastic import demand. The above approach of ranking commodities has been applied to 87 commodities covering almost all the commodity groups.

A comparison of the composite score with the existing octroi rates highlights the need for rate changes to bring the structure closer to the 'desired' one. The proposed changes preserve the revenue-neutrality. As such, the suggested octroi structure is dramatically different from the existing one. It removes the fiscal anomalies which had crept in the relative octroi rates, both within and across commodity groups. On the whole, the proposed structure has become more equitable, efficient and buoyant.

Revenue-neutrality of the exercise was important to make it move meaningful and acceptable to local governments in view of the overall significance of octroi in local revenues in Pakistan.   However, for governmental units operating under resource constraints, tax reductions may generally not be the most pragmatic solution to the problem of fiscal anomalies. This requires foregoing revenue benefits for which political costs have already been incurred. Therefore, perhaps a better way of moving towards a rationalised octroi structure, in the short run, is to enhance rates on commodities on which the current tax rate is lower than what the 'desired' rate should be, but, not reduce the rate on others.

The proposed change in the octroi rate structure is as follows:

RELATIVE RATES AMONG COMMODITY GROUPS

Types of Goods	Existing Average Effective Octroi Rates (%)	Proposed Average Effective Octroi Rate (%)
Consumers Goods		
Food and Drinks	0.35	0.25
Consumers Durables	0.26	0.36
Others	0.25	0.35
Raw Materials/Intermediate Goods	0.36	0.33
Capital Goods	0.36	0.25

On the whole, if rationalisation is followed by periodic rate escalations of the type given below, then the buoyancy of revenues is likely to he doubled over the years.

INDEX OF INCREMENTAL BUOYANCY OF OCTROI

	Without Periodic Rate Escalations	With Periodic Rate Escalations
Existing Rates	1.00	1.00
Rationalised Rates	1.20	1.96
Proposed Rates	1.39	2.00

Adoption of the proposed octroi rates are likely to lead to substantial revenue gains for the local governments in the country. Additional revenue mobilisation is estimated to be Rs one billion in 1995-96. This will increase to over Rs five billion by the year 2002-03.

CHAPTER ONE

THE OCTROI TAX IN PAKISTAN

1.1   PERFORMANCE OF REVENUES

The Octroi tax is the largest single source of revenue of local governments. In Karachi almost 80 percent of KMC tax receipts are generated through this head. Octroi is imposed on goods imported into the municipal limits for local use, sale or consumption. The tax is generally collected by private contractors. Privatisation of octroi collection, in mid-to-late 70's generally resulted in a significant increase in revenues possibly because of less evasion. In the case of consignments entering by road and rail transport the basis of taxation is weight in terms of hundred kilogram units. Flat rates of octroi are imposed per hundred kilos and these rates vary among commodities.

1.2   RESULTS OF EARLIER RESEARCH

Results of earlier research reveals that first, octroi rates are very low particularly on food items. The incidence is generally less than one percent. Second, the effective tax rates (tax rate as a percentage of commodity price) shows that octroi burden is higher on some basic food items compared to some luxury consumers goods.

1.2.1 Rate Variation Among Commodities

Octroi rates are specific in the case of land dues. Rates are low and have remained unchanged for the last ten years. Table 1.1 reveals that the average effective rate are very low at about 0.17 percent of consumer prices. A large number of items have rates below 0.1 percent. Rates are relatively high for some food items like vegetable ghee (0.46 percent), sugar (0.56 percent), fruits (0.19 to 0.58 percent), betel nuts (0.30 percent) and onion (0.24 percent). This has exacerbated the regressivity of the octroi structure. On the contrary, low rates in the case of consumer durables like refrigerator, tape recorder, motor cycle and car, etc. are observed. A summary of commodity-wise variation shows that out of 115 selected commodities about 43 percent are charged at the lowest rates ranges from 0 to 0.1 percent, 44 percent of the commodities at an intermediate rate of 0.11 to 0.30 percent, while only about 1 percent of the commodities are charged at the higher rate above 0.30 percent as shown in table 1.1.

1.2.2 Presence of Fiscal Anomalies

As mentioned earlier octroi burden is higher for food items as compared to luxurious consumers goods. For example, the effective octroi rate for a sample of food commodities like vegetable ghee, sugar, fruits, betel nuts, onions, etc. ranges from 0.25 to 0.50 percent. As compared to this the effective rate for consumer durables like air-conditioners, refrigerators, tape recorders, motor cycles and cars, television sets are lower, ranging from 0.03 to 0.13 percent. As such not only is there scope for octroi rate escalation but, there is also need for rate rationalisation to remove such anomalies.

1.2.3 Rate Variation Among Cities

Although, the commodity schedule has been standardised, rates vary from city to city. As such, an index of current octroi rates of commodity groups for a sample cities has been calculated, results of which are presented in Table 1.2. The table shows that the highest index of octroi rates is in Jahanian Town Committee which has a value of 125 [average for the samples of cities = 100] while the lowest value of 71 is observed for land post in Karachi. There does not appear to be any systematic pattern of variation in octroi rates either by province or by city size. Table 1.2 shows that among cities with the same municipal status, some index values are above average and others below average. Similarly, within a province some cities have above average octroi rates and other below. For example, included in the sample cities of Punjab, Lahore and Chak Jumra have an index value below 100 while for Faisalabad, Kasur, Chiniot and Jahanian the index is above 100. By and large, it seems that variation among cities in the overall index of rates is not very pronounced.

It is also observed that rates in some cities are significantly higher for some commodities while for other commodities they are visibly lower. Commodity groups with high variation in octroi rates across cities include articles of lighting and fuel, drink, smoking and chewing, cleaning and washing, clothing and metals & machinery. It seems that the rates on food items vary less among the local councils, while there is more variation in rates on non-food items.

1.2.4 Commodity-wise Composition of Revenues

Octroi rates are specific in nature at inland posts and ad valorem at the sea and air posts. As a result the contribution of air and sea dues to total revenues in KMC has increased to over 84 percent in 1990-91. In the case of land dues rates are low and have not been revised very frequently.

Commodity-wise composition of octroi revenue for a sample of cities is presented in Table 1.3. The table indicates that the largest contribution to octroi revenues is by food items. It ranges from 62 percent of total octroi revenues in the smallest sample city (Raiwand) to 18 percent, in the biggest city (Lahore), on which information is available. In general, octroi in the bigger cities appears to be more broad-based. Since taxation of food items is considered to be regressive with a relatively high burden falling on the lower income groups, it appears that the overall incidence of octroi is more regressive in smaller cities/towns.

Despite the large number of commodities in the octroi list the distribution of revenues by commodity group appears to be skewed. In Karachi, six commodities groups contribute almost 96 percent of the octroi revenues. Table 1.4 indicates that the largest share, over 39 percent, of revenues is from textile goods, leather and leather goods and articles of apparel. Next come the articles of food and drink, with a share in excess of 21 percent. The shares of other commodity groups range between 8 and 10 percent. Altogether, the dependence of octroi revenues from land dues on basic commodities like foods, textiles, drugs, medicines, building material, etc., implies that the incidence of this component of octroi is likely to be fairly regressive in character. Also, buoyancy of revenues may be low because of the relatively slow growth in demand basic items like food, clothing, etc.

CHAPTER TWO

CITY-WISE VARIATION OF OCTROI RATES

2.1   CHOICE OF SAMPLE CITIES

The analysis in this chapter is based on the current octroi tariff structure of 22 local councils in the country. The selection of the sample local councils/cities ensures the coverage of all the four provinces and of all types of local councils. This was important to ensure that variation across provinces and size/municipal status of cities, if any, are adequately captured in the analysis. A list of sample local councils is presented in Table 2.1. In all, sample includes two metropolitan corporations, 8 municipal corporation, 8 municipal committees and 2 town committees. A higher coverage of municipal corporations and municipal committees in reflective of a higher share of urban population residing in cities with municipal committee/corporation status.

The distribution of the sample local councils in such that there are 14 local councils from the province of Punjab, 3 from Sindh, 3 from NWFP and 1 from Balochistan. Again a higher coverage of Punjab province is due to a higher share of urban population residing in the province.

2.2   STATUS OF LOCAL GOVERNMENT/CITY SIZE AND OCTROI RATES

Average octroi rates by type of local councils are presented in table 2.2. Detailed rates for 89 commodities, which account for the bulk of octroi revenues, are presented. The table clearly shows

that on the whole, average octroi rates tend to decrease with an increase in municipal status. This is true in the case of almost all commodity groups. The average octroi rate on wheat, for example, decreases from Rs 1.3 per 100 kgs in the case of town committees to about Rs 0.4 per 100 kg in metropolitan corporations. Similarly, average octroi rate on cotton cloth declines from Rs 20 per 100 kg in town committees to about Rs 13 in metropolitan corporations. Exceptions to this are few and are largely observed in the case of luxury or non-essential consumer goods like perfumes, cosmetics, beverages, fruit juices, washing machines etc. Lower rates in the larger cities may be due to greater dependence on property tax and a larger octroi tax base.

The variations in octroi rates across cities with different municipal status is highlighted by the high magnitudes of the coefficient of variation[1], presented in table 2.3. These, range between 45 and 100 percent and increase to much higher values in some cases. Also, it appears that there is greater variation in rates among smaller cities with the status of a town committee.

2.3 VARIATION IN OCTROI RATES BY PROVINCE

There does not seem to be systematic variation in the octroi rates by province. Rates on different commodity groups are higher in different provinces (see table 2.4). The only apparent exception to this is in the case of Balochistan, where higher octroi rates in Quetta tends to raise the average octroi rate in Balochistan.

---

[1]   computed as COV = $\dfrac{\text{Standard deviation}}{\text{Mean}}$

Altogether, our analysis shows there are some differences in octroi rates by province and by city size with same municipal status. Average octroi rates, appear to be in general higher for smaller local councils. This conclusion is by and large consistent with that of the earlier studies. The existing tax rates are somewhat higher than those reported in earlier studies. This is because local councils have enhanced octroi rates during the late 80's and 90's. Table 2.5 shows that, on the average octroi rates have been enhanced by about 35-40 percent. Rate escalations have been higher in the case of non-essential goods and luxury consumer goods. For example, octroi rate on air conditioners, refrigerator, deep freezers have been increased by about 140-150 percent in the sample local councils.

CHAPTER THREE

COMMODITY-WISE EFFECTIVE OCTROI RATES

In this chapter we quantify the commodity-wise variation in octroi rates and identify factors which explain this variation.

3.1   CHOICE OF COMMODITIES

We have selected five types of commodities) food and drinks, consumer durables, raw materials/intermediate goods, capital goods, others) for the analysis of effective rates on the basis of the following criteria: first, that all commodity groups on which octroi is levied are covered, second, that major items from the viewpoint of revenue contribution are included, and third, that secondary price information is available for different locations to enable computation of effective rates.

Within the 5 commodity groups selected, 26 are articles of food and drink; 8 are items of lighting and fuel; 2, animal and animal products; 9, building materials; 6, items of furniture and fixtures; 13, articles of clothing, dress and wear, etc.

3.2   EFFECTIVE OCTROI RATES

Effective octroi rates (EOR) are derived for each city as the ratio of the flat rate octroi to the price of the commodity. For consumer goods, the effective rate has been derived with respect to retail price while in the case of raw materials, intermediate goods and capital goods wholesale price has been used.

Given the need for price data the analysis is restricted to nine cities (Karachi, Lahore, Faisalabad, Hyderabad, Peshawar, Quetta, Rawalpindi, Sukkur and Nawabshah) for which this information is available from the Federal Bureau of Statistics.

EORs by commodity and the average for commodity groups is given in Table 3.1. There is substantial variation in these rates, ranging from a minimum of only 0.11 percent to a maximum of 2.60 percent.

3.3   DETERMINANTS OF VARIATION IN EFFECTIVE RATES

We now analyse if there is a pattern of variation in these rates. A summary picture by type of commodity is given below:

AVERAGE EFFECTIVE OCTROI RATES BY TYPE OF COMMODITY

Type of Commodity	Average Effective Octroi Rate (%)
CONSUMER GOODS	
Food and Drinks	0.35
Consumer Durables	0.26
Others	0.25
RAW MATERIALS/INTERMEDIATE GOODS	0.36
CAPITAL GOODS	0.36

The table above indicates that octroi rates do vary significantly by type of commodity. Commodity groups with the lowest octroi rates are other consumer goods and consumer durables with the average

EOR of 0.25 percent and 0.26 percent respectively. Food and drinks are among the highest octroi rate category alongwith capital goods and intermediate goods, with average EOR of about 0.35 to 0.36 percent. Therefore, there are major fiscal anamolies in the existing octroi structure. Commodities which are of a basic nature have the highest rates while luxury consumer durables have the lowest tax burden. This violates the basic norms of taxation of equity.

Furthermore, even within individual commodity groups there are substantial variations in octroi rates among items. For example within the food category the EOR on sugar is as high as 0.91 percent while that on cigarettes is as low as 0.22 percent. As such, our analysis indicates that fiscal anamolies have emerged in the octroi structure over time and there is need to rationalise it and bring it in line with the basic norms of taxation.

CHAPTER FOUR

CRITERIA FOR FIXATION OF OCTROI RATES

Previous chapters have highlighted the anamolies that have crept into the octroi tax structure over time and the need for rationalisation of these rates. This section of the report develops the strategy for rationalisation of the rate structure. Contrary to the policy historically of making uniform rate increases (in percentage terms) we recommend that future revisions should be selective in terms of commodity groups. The strategy of selective enhancements should be consistent with the following objectives:

1.   to make the octroi structure more equitable/progressive by focussing on those commodities the burden of which falls more on the higher income groups. This will at least partially alleviate the basic problem with the octroi, relating to the perceived regressivity of its burden;

2.   to make the structure more efficient and preserve the revenue base as octroi is by far the main source of local government revenues in Pakistan; and finally,

3.   wherever possible, the rate ought to be enhanced in commodities which are likely to experience fast growth in import demand. This will contribute to enhancing the built-in buoyancy of the octroi.

The methodology for proposing tax rate changes, based on the above, proceeds first by setting up criteria on the basis of which different commodities can be ranked in terms of the `desired' level of octroi rate. This is followed by an analysis of the desired with the actual rate. Wherever the difference between the two is significant then such commodities become candidates for rate change. However, to preserve revenue neutrality of the exercise it is ensured that the overall average effective tax rate remains unchanged.

The criteria used by us for ranking the different commodities is as follows.

4.1   TYPE OF GOOD

As a general rule, the rate of taxation on basic consumer goods, especially food items, should be kept low as any associated increase in prices is likely to hit poorer households more. Next, it is also desirable to keep the rates on capital goods as low as possible so as to encourage investment in the regional economy which contributes to an enhancement in the size of the tax base. In the case of intermediate goods which are processed by industry within the metropolitan/municipal limits there is a greater probability that the burden will fall on capital income accruing to owners and share holders of industrial equity. The burden, as such, is likely to be more progressive.

Therefore, the following values are assigned to different types of goods. If basic consumer good, S_1 = 0, if capital goods, S_1 = 0.5, if intermediate good, S_1 = 1 and if luxury consumer good, S_1 = 2.

4.2   TYPE OF INCIDENCE

Given the nature of the good, the next criterion relates to its incidence by income groups. This can be identified directly in the case of consumer goods given the prevailing expenditure patterns of households in the urban areas. For particular intermediate goods or capital goods we first identify through the input-output table the uses in different industries of such goods and the impact of taxes on them on final demand. Following this the incidence by income level of consumer can be determined.

We assign the following values: if incidence is regressive, $S_2 = 0$, if incidence is neutral, $S_2 = 1$ and if incidence is progressive, $S_2 = 2$.

4.3   BUOYANCY OF DEMAND

By analysis of the recent data on national imports and the income elasticity of demand of different commodities we are able to rank different commodities in terms of the buoyancy of demand as follows: if slow growing (with a low income elasticity of demand) then $S_3 = 0.5$, if income elasticity is in the range of 0.5 and 1.0 then $S_3 = 1$ and if in excess of this, $S_3 = 2$.

4.4   MINIMISATION OF DISTORTIONS

Another criterion related more to economic efficiency is the need, to the extent possible, to minimise the distortions in import demand created by octroi. This criterion implies that, other things being equal, higher octroi rates should be specified on those commodities import demand for which is relatively price inelastic. In such cases, the impact on demand would be less and the resulting distortion (dead weight

loss) would have a smaller magnitude. Also, in such cases, loss of revenues due to contraction in demand would be less.

As such, we assign the following values: If demand is highly price elastic, $S_4 = 0.5$, if demand is moderately price elastic, $S_4 = 1$, and if demand is price elastic, $S_4 = 2$.

These four criteria are used to rank different commodities is terms of desirability for octroi taxation. The composite score is derived as the sum of the score in each criterion. Altogether, the composite score, S has a minimum value of 25 and a maximum possible value of 200.

4.5   APPLICATION OF CRITERIA

The above approach of ranking commodities has been applied to 87 commodities covering almost all the commodity groups[1]. Results of the application are presented in table 4.1. Among the 87 commodities, the highest composite score, of 162.5, is attained by 14 commodities which include non-essential, luxury items of durable or non-durable consumer good nature. For example, air conditioners, refrigerators, deep freezers, tiles and glazed titles, cosmetics and perfumes are among the highest score commodities. Lowest composite score of 62.5 is of 29 commodities most of which are essential food items like wheat, maida, sugi, gur, shakkar, vegetables, salt and spices of various types. Non-food items with the lowest score include low-income consumption basic goods like fuel wood, kerosene oil, second-hand clothing, cement, blocks, household utensils etc.

---

[1]   Indicate what percentage of revenues they account for on average.

The next stage in the analysis is to study the relationship between the composite scores of different commodities and the existing octroi rates. This can be done visually from table 4.1. The octroi rates have been scaled so that these can be directly compared with the composite score. In general, octroi rates are low and there is clearly a need for revisions to make the structure more rationale.

CHAPTER FIVE

THE PROPOSED OCTROI SCHEDULE

A comparison of the composite score with the existing octroi rates in the previous chapter highlights the need for rate changes to bring the structure closer to the `desired' one. There are commodities which have octroi rates very low in relation to the score or those where actual rates are very high is compared to their score. The first type of commodities are candidates for rate enhancement and the second type for possible rate reduction.

These commodities are identified in table 5.1. Altogether our analysis reveals that there are 37 commodities where tax rates need to be enhanced and potentially 49 commodities where there is a case for reduction. Major commodities in the former group include cosmetics, perfumes, synthetic yarn, leather, silk and woollen cloth, building materials, timber, air conditioner and television. Rate escalations of about 36 to 300 percent are required in these commodities. Candidate commodities for rate reduction include wheat flour, maida, suji, gur, shakkar, ghee, spices, washing soap, fuel wood, kerosene oil, high speed diesel oil, commercial acid, second hand clothes, cement, and bicycles.

The proposed changes perserve on average the revenue-neutrality of revenues. This is important because octroi in the single largest source of revenue for urban local councils in Pakistan. Erosion in revenues, would have severe adverse implications for the local councils.

5.1   Proposed Relative rates among commodity groups

The suggested octroi rates vary significantly by commodities (see table 5.1). Rate variation by type of commodities is presented in table 5.2. Commodity groups with the lowest rates will be food and drinks and capital goods with an average EOR of about 0.25 percent. The former is largely motivated by equity considerations whereby municipal governments attempt to minimise the impact of taxation on poorer households by lower octroi rates on essential commodities which account for a larger share of income of such households. In the case of the latter the motivation is to encourage investment within the municipal jurisdiction by lower rates of taxation of machinery. Raw materials and intermediate goods will generally attract higher rates of octroi. Similarly, octroi rates on consumer durables like washing machine, TV, refrigerator, etc., will be high because the burden falls largely on the upper income groups.

As such, the suggested octroi structure is dramatically different from the existing one. It removes the fiscal anamolies which had crept in the relative octroi rates, both within and across commodity groups. On the whole, the structure will become more equitable, efficient and buoyant.

5.2   Level of Rates for Revenue Neutrality

As already mentioned, the rationalisation excercise has been undertaken in a framework which ensures revenue neutrality. The overall existing average effective octroi rate in Pakistan is estimated to be 0.30 percent. The suggested octroi structure has the same overall average effective rate. As such, application of the new structure to the existing tax base in the country is likely to yield the same

revenues. Revenue-neutrality of the exercise was important to make it meaningful and acceptable to local governments in view of the overall significance of octroi in local revenues in Pakistan.

The implied suggested octroi tariff structure is presented in table 5.3. Rates vary from a minimum of Rs 0.66 per 100 Kg in the case of wheat grains etc. to a maximum of Rs 200 per 100 Kg on woollen cloth.

5.3   Methodology for Periodic Fixation of Specific Rates

The preceeding analysis in this chapter presents strategy for octroi rate revision such that revenue neutrality is ensured. This requires rates escalation in some cases and reduction in others. However, for governmental units operating under resource constraints, tax reductions may generally not be the most pragmatic solution to the problem of fiscal anamolies. This requires foregoing revenue benefits for which political costs have already been incurred. Therefore, perhaps a better way of moving towards a rationalised octroi structure, in the short run, is to enhance rates on commodities on which the current tax rate is lower than what the `desired' rate should be but not reduce rate on others. This constitutes a step towards bringing the relative tax rates more in line with the `desired' structure. Furthermore, it means additional resource mobilisation, which for a self-financing local government is likely to be welcomed.

The above strategy of selective rate enhancement should be followed until the relative difference in octroi rates, across commodity groups, is attained. Beyond that, uniform escalations may be resorted to for all commodity groups until significant changes in the effective octroi rate structure again occur.

Based on the above strategy the proposed octroi rates are presented in table 5.4. Octroi rates on 49 commodities remain unchanged, since these are lower than the recommended rates. Rates on 37 commodities are enhanced (see Table 5.5). On the average, this involves rates enhancement of about 27 percent. The proposed octroi structure is estimated to yield additional revenues of about Rs 670 million at the current octroi base of the local governments in the country.

5.4 Projected Elasticity of Revenues

Rationalisation of octroi rates on the lines proposed in this report is likely to significantly enhance the buoyancy of octroi revenues. This is so because the underlying buoyancy of imports has been taken as a independant criterion for rationalising the rate structure. Table 5.6 presents the index of incremental buoyancy coefficient of octroi revenues both under the existing and the rationalised revenue-neutral proposed structure. The table clearly shows that rationalisation increases the buoyancy of octroi revenues. That is, even if there are no immediate revenue gains to local governments in the country, rationalisation increases the growth potential of the tax and will lead to faster increases in revenues in future years. If rationalisation is followed by periodic rate escalations of the type suggested in the previous section, then the buoyancy of revenues is likely to double overtime. In the case of the

proposed structure, enhancement in buoyancy is slightly higher than in the case of a revenue-neutral change.

Adoption of the proposed octroi rates are likely to lead to substanted revenue gains for the local governments in the country. Additional revenue mobilisation is estimated to be Rs 1

TABLE 5.6
INDEX OF INCRMENTAL BUOYANCY OF OCTROI

	Without Periodic Rate Escalations	With Periodic Rate Escalations
Existing Rates	1.00	1.00
Rationalised Rates	1.20	1.96
Proposed Rates	1.39	2.00

billion in 1995-96 (see table 5.7). This will increase to over Rs 5 billion by the year 2002-03, increasing octroi revenue by about 75 percent, over projected revenue with existing rates.

TABLE 5.7
ADDITIONAL REVENUE GENERATION FROM
OCTROI FOLLOWING IMPLEMENTATION
OF THE PROPOSED STRUCTURE

	[Rs in Million]
Years	Additional Revenue Generation
1995-96	1070
1996-97	1395
1997-98	1700
1998-99	2240

1999-2000	2800
2000-2001	3480
2001-02	4290
2002-03	5250

On the whole, rationalisation of octroi rate, on the lines suggested in this report are likely to make the structure more equitable, efficient and buoyant and contribute to a significantly higher level of revenues by turn of the century.

TABLE 1.1

EFFECTIVE OCTROI RATES? IN LAND DUES??

Effective Octroi Rate	Number of Commodities
0 - 0.10%	49
0.11% - 0.20%	41
0.31% - 0.30%	10
0.41 - 0.50%	6
Above 0.50%	5
Total	115???

Average Effective Rate = 0.17%
Medium Effective Rate = 0.12%

? Effective Octroi Rate = $\frac{\text{Specific Octroi Rate}}{\text{Consumer Price}}$ x 100%

?? for a sample of 12 cities across the four provinces.

??? covering most of the commodities included in the schedule. Commodities for which prices were not available have not been included in the analysis.

TABLE 1.3

COMMODITY-WISE COMPOSITION OF OCTROI REVENUE
IN A SAMPLE OF CITIES

Commodity Groups	Metropolitan Corporation Lahore 1985-86	Municipal Corporation Quetta 1986-87	Municipal Corporation Sukkur 1987-88	Municipal Committee Charsadda 1987-88	Town Committee Raiwand 1988-89
Food	17.8	20.1	38.2	23.3	61.6
Wheat	2.4	N.A	3.8	N.A	3.5
Rice	0.8	N.A	1.0	N.A	0.3
Ghee/Edible Oil	2.4	N.A	10.8	N.A	12.2
Sugar	2.6	N.A	3.1	N.A	21.6
Fruits	5.0	N.A	6.0	N.A	8.7
Others	4.6	N.A	13.5	N.A	15.3
Drinks	0.2	8.0	2.4	??	1.9
Smoking and Chewing	3.0	7.2	1.5	3.1	)
Textile, Wearing, Clothing etc.	13.3	13.3	16.3	7.6	5.6
Medical, Chemical, Pharmaceuticals	10.4	12.8	6.2	3.5	?
Lighting and Fuel	6.1	7.0	3.2	2.3	?
Building Material	5.1	11.6	8.7	11.7	?
Furniture and Fixtures	4.9	1.6	6.4	4.2	2.0
Iron, Metallurgical and Mechanical	7.2	1.0	1.6	6.8	?
Animal and Animal Products	7.4	0.6	1.5	?	9.8
Conveyance	5.2	0.8	2.0	?	?
Others	19.4	16.0	12.0	37.5	19.1
TOTAL	**100**	**100**	**100**	**100**	**100**

_____

? Included in others.
?? Included in Food.

SOURCE: Case Studies, from Jinswars maintained by the Octroi Department.

TABLE 1.4

LAND DUES OCTROI COLLECTION BY COMMODITY GROUP IN KARACHI

	Amount (Rs. in Million)	% Share	Cumulative Share %
1. Textile materials, textile goods, leather and leather goods, articles of apparel	62.1	39.4	39.4
2. Articles of Food and Drink	33.7	21.4	60.8
3. Metals, metal products, machinery, etc., mineral products	19.4	12.3	73.1
4. Spices, drugs, medicines, dyes, chemicals, toilet requisites	13.3	8.4	81.6
5. Stationery and paper goods	12.8	8.1	89.7
6. Articles used for construction and furnishing, building materials, mineral products	9.7	6.2	95.9
7. Others	6.5	4.1	100.0
8. Total	157.5	100.0	

SOURCE: Metropolitan Resource Generation Study, AERC.