

PAKISTAN'S ECONOMY AND BUDGET 2019-20

Critical Issues and Some Recommendations

Policy Brief

This policy brief is contributed by an IPS team led by Fasih Uddin, former chief economist of the Planning Commission of Pakistan and a veteran member of Institute of Policy Studies (IPS), Islamabad. He is also the author of *Pakistan's Economic Journey: Need for a new Paradigm* and *Pakistan under IMF's Shadow*. Asim Ehsan, research officer at IPS' economy desk and Amanullah Khan, former president Rawalpindi Chamber of Commerce & Industry (RCCI) and Islamabad Stock Exchange (ISE) have also contributed in the preparation of this brief.

The PTI coalition government will present its first full-year budget 2019-20 in parliament in mid of next month, i.e., June 2019. The current year's budget was prepared by the previous government and subsequently subjected to minor changes proposed by the current government when it assumed power. Thus, the forthcoming budget should be seen as an important step towards PTI's objectives including 'building just and equitable society', as enshrined in the Madinah Charter and visualized by the father of the nation. This budget should also be seen in the backdrop of current year's economic performance, chronic issues such as unemployment, poverty, public debt, poor social services, high level of corruption, poor governance, low rate of savings and investment, and water and energy crises. It should be appreciated, however, that while these issues need sustained and long-term efforts, the forthcoming budget could be used as critical step for setting the direction.

The international institutions (e.g., IMF, World Bank, Asian Development Bank) as well as national institutions (State Bank of Pakistan and Pakistan Bureau of Statistics) have assessed the state of the economy during the current year. The Economic Survey, Annual Plan and other documents that will be released with the Budget in a couple of weeks will give updated position of the economy. Indications are that, in general, the performance is below the planned

target. The fiscal deficit is likely to be above 7% of GDP which is mainly contributed by shortfall in tax revenues, rise in debt servicing and defense related expenditures. GDP growth is likely to be way less than 5.2% recorded in the previous year and feared to be around 3% in 2018-19. The main area of concern, however, relates to external economy and rising prices. The inflation rate in 2018 was 3.9% and in 2019 it is leaping towards double figures i.e., 9.4% (March 2019) and projected to remain high in 2019-20. The foreign exchange came down to precarious

The GDP growth is likely to be way less than 5.2% recorded in the earlier year (2017-18).

level and external debt repayment liabilities compelled to seek funding from friendly countries and international institutions. Despite funding arrangements with Saudi Arabia, UAE and China, the government had to negotiate a medium-term arrangement with IMF. The rupee depreciated substantially while there is also stress owing to steady rise in international oil prices. These have adversely impacted the economy; petroleum prices were frequently raised resulting in energy and transport cost rise. Depreciation also resulted in increase in cost of external debt in rupee. The people suffered due to rise

in prices with inflation likely to exceed 9% during the fiscal year. This coupled with unemployment, poverty, societal disparity in income and wealth and poor social and environmental conditions have made the life of common man difficult. The current government has taken some initiatives in health, education and housing sectors. Some more may be forthcoming in the coming years. Mobilization of resources for financing these programs and managing them in an effective way will be a real challenge.

This government will have a heavy agenda for next year and the main burden will fall on the budget. Many tasks will have to be addressed. On economic front it

The flawed approach and practices of tax collection machinery of the government keeps burdening the existing tax payers with more taxes instead of bringing non-taxpayers into the tax-paying circles.

should attempt a balance between stabilization (fiscal deficit, public debt, monetary stability, foreign exchange reserves, exchange rate, inflation etc.) and sustained and inclusive growth. Other areas of attention are human development and welfare, environment and climate change, national security, governance and clean society. The focus has to be on such repeatedly highlighted areas as, people's welfare, equity, justice and equal opportunities for all.

In order to have macroeconomic stability and fast economic growth, experts opine that, it is necessary to sustain GDP growth rate of 7 to 8% for at least 10 years without any interruption. To attain such a high growth-rate it is inevitable to ensure increase in investment over 20% of total GDP, along with raising factor productivity and efficient use of resources. Clear policy and confidence creating measures are the basic parameters required for investment promotion.

The next year's budget is being prepared under certain compulsions. Firstly, commitments made in the PTI Manifesto as well as aspirations and expectations of the people. Secondly, security considerations and obligations arising out of past actions (such as debt servicing and CPEC commitments). Thirdly, mega projects planned or in the pipeline (such as Dams and

Ports). Fourthly, NFC award and 18th constitutional amendment. Lastly, medium-term program finalized with the IMF. These are briefly discussed below:

- Notwithstanding the criticism generally levelled against IMF, the most important element in the budget will be the Pak-IMF bailout arrangement. In fact, it will lay down the medium-term framework (3-4years) for fiscal, monetary, exchange rate and balance of payments policies. The arrangement will be closely monitored and periodic disbursement of funds will be subject to meeting set criteria and benchmarks. The focus of arrangements will be on stabilization as against accelerating growth. It is feared that cost will largely fall on common man. The government has to remove this feeling by taking appropriate actions. In order to contain inflation, a campaign of austerity, reliance on local/national products and reduce imports will be required. Rationalization of taxes on local products is also a promising initiative.
- The 18th constitutional amendment and 7th NFC Award have changed the fiscal structure. While most taxes are collected by the Federation, its share is now less than half. Many areas such as health, education and housing, about which present federal government has ambitious plans, are now in the domain of provinces. Thus, federal budget should be reviewed along with the provincial budgets.

The 8th NFC Award is overdue by few years and the next budget is based on the 7th NFC Award of 2010. It is high time to constitute the new commission and ensure that the budget for 2020-21 is based on the new Award.

- It is said that tax system has been reformed yet collection has not improved. Pakistan's tax to GDP ratio is less than 10% which is amongst the lowest in the world. It is rightly believed that the country has potential of increasing tax revenues without increasing tax rates. This can be done by serious tax reforms and enhancement of progressive taxes, while limiting tax exemptions only to targeted areas.

One budget cannot resolve all the problems. The budget should be a part of a grand design and it should at least be based on a three to five years' vision.

Something innovative and drastic is required for tapping the potential, eliminating corruption, reduction of tax evasion and broadening the tax base. In this context, the Value Added Tax (VAT) is a promising area which has not been introduced so far under the pressure of vested interests. This proposal should be revived. A comprehensive scheme of increasing tax base is proposed by FPCCI (Federation of Pakistan Chambers of Commerce & Industry) which emphasizes on enhancement of people's confidence in paying taxes. Tax reforms process should involve industrialists and businessmen feedback and views.

- We need higher tax coverage, lower tax rates, less reliance on indirect taxation and progressive tax regime. FBR should move away from predatory taxation and serious efforts are required to restore trust of people. Tax should be collected from people who do not pay taxes and existing tax payers should not be excessively burdened. Form and procedures of tax on individuals, in particular, need to be simplified and incentives provided to induce them to pay tax voluntarily. Strong institutional framework and initiatives are required to revive the system of Zakat and Ushr.
- Fiscal discipline is a neglected area. Successive governments have ignored the

restraints on public debt under the Fiscal Responsibility and Debt Limitations Act 2005.

- Revival of agricultural sector is inevitable in order to boost the economy of the country. In this regard, the government should ensure availability of credit facilities to whole of the sector in general and to small scale farmers in particular. Low input cost along with improved marketing and storage facilities for agriculture products is recommended in order to boost agriculture sector.
- The loss-making public sector enterprises (Pakistan Steel Mills, PIA, etc.) are a constant drain on the budget and banking system. Indecisiveness and status quo are causing more harm and creating uncertainties. These should be either privatized or restructured and made profitable.
- Pakistan's national savings remains very low (about 14-15% of GDP) and are one of the main causes of low economic growth and dependence on external borrowing. Measures should be taken to discourage conspicuous consumption and encourage savings.
- Factor productivity (Labor, capital, energy, inputs) in the country is low and wastage of material and manpower is high. This neglected area needs special attention. Increase in the level of technical education with more institutes and trainings on very strict international standards and methodology are needed. Cost benefit analysis criteria should be used in PSDP mega projects instead of political motivations.
- The government is planning mega infrastructure projects such as dams, ports, highways, railways and tourism. Serious, integrated and consistent efforts are required to mobilize internal and external resources for them.

- The lack of consistency and perseverance in macroeconomic policies pose serious concerns to the national economy.
- Governance and corruption issues are serious concerns and the emphasis of current government on mega corruption scandals is a good step. However, more attention is required on smaller segments like, health, education and housing etc. The involvement of government officials in hiring and posting of people at high level seats without following criteria of competency and fitness for the job would not lead to good governance. These aspects are in contradiction with Election Manifesto 2018 of PTI which is currently ruling in center and two provinces.

To sum up, the task ahead is difficult and challenging which requires tough decisions. One of the main causes of current malign is the tendency of the past

governments to prefer soft options against the hard ones. They, for instance, opted for public borrowing instead of attempting to raise tax revenue. Need of the hour is a movement for self-reliance and comprehensive austerity drive with focus on public welfare and inclusive progress.

The flawed approach and poor practices of tax collection machinery keeps burdening the existing tax payers with more taxes instead of bringing new taxpayers into the tax circles. Innovative approach is required to broaden the tax base, monetize the economy and encourage people to pay taxes.

One budget cannot address all problems, but it should at least set an effective base to achieve national objectives within a medium and long-term framework. The practice of preparing five-year and perspective plans should continue so that all development efforts are set out in an integrated framework with a long-term vision.

For queries:

Syed Nadeem Farhat

Senior Research Officer

nadeem@ips.net.pk | www.ips.org.pk