IPS Brief No: BR-2019-V-JE

Institute of Policy Studies
Islamabad

June 14, 2019

Roundtable

Federal Budget 2019-20

Institute of Policy Studies
Islamabad

Budget Review

This brief is based on the proceedings of a roundtable session on Federal Budget 2019-20 at Institute of Policy Studies, Islamabad.

The budget 2019-20 can be taken as an economic agenda-setting framework of the ruling political party. At the same time, however, it should not be seen in isolation from overall economic and political environment, which, as is well known, is quite depressing. Improvement or otherwise, in the overall environment is important as political instability and uncertainty in the economic arena act as a catalyst in worsening conditions for investment and development. Moreover, the budget should also be seen as an important step towards PTI's proclaimed objectives including 'building a just and equitable society' as enshrined in the Madinah Charter and visualized by the father of the nation[1]. The current budget will also be seen as a critical step in setting the economic direction keeping in consideration the grim economic situation of the country. The point of analysis in budgetary exercise is to what extent it addresses the core economic issues of the country; what it provides for to consolidate the gains and what is in there for flourishment and development of economic and business activity, in an environment where various social segments and specifically underprivileged sectors of the society attach a lot of expectations from the budget for their well-being. In this background, the federal budget 2019-20 shall be reviewed, starting with a brief outlook of the key economic indicators of the country in the outgoing fiscal year 2018-19.

Economic Outlook: key Indicators 2018-19

The economy is showing worrisome signs in all key economic indicators in the outgoing fiscal year 2018-19. Comparing the data of Pakistan Economic Survey 2018-19 with FY2017-18, a substantial downfall is seen in all sections of the economy. GDP growth has fallen to 3.29% as against 5.79% in FY 2017-18. The downfall in GDP growth has been substantially contributed by each major section of the economy. While the targets set in the budget of 2018-19 have not been achieved, the more troubling aspect is the considerable decline in the growth rates in almost all economic indicators. Large scale manufacturing (LSM) is posing serious concerns as the growth in the sector is negative. Similarly, agriculture sector is growing at almost flat rate. The services sector is relatively better but it is also showing a decline from the previous year. Inflation has increased to 8.8% from 3.78% (FY18) and is expected to grow near double figures in forthcoming quarters. Low GDP growth and negative trends in LSM have seriously contributed in rise of unemployment level which subsequently increases poverty. High inflation rate and policy rate at 12.25% presents an unpleasant picture to attract private investment. The overall worsening situation can be gauged, as an example, from the decline in demand of medicines which normally has an inelastic demand.

[1] Page 06, PTI Vision, PTI Manifesto 2018

Table 1: Key Economic Indicators

	Economic Survey 2017-18	Economic Survey 2018-19
GDP Growth	**5.79%**	**3.29%**
Agriculture Sector	**3.81%**	**0.85%**
Industry Sector	**5.80%**	**1.4%**
Services Sector	**6.43%**	**4.7%**
Large Scale Manufacturing	**6.13%**	**(2.06)%**
Total Investment to GDP (%)	**16.7%**	**15.4%**
Tax Revenue	**Rs. 2626 billion (3 quarters)**	**Rs. 2900 billion (3 quarters)**
Inflation	**3.78%**	**8.8%**

Source: Pakistan Economic Survey 2017-18 and 2018-19.

There is an increase in the first three quarters in Tax Revenue collection compare to the fiscal year 18. Nevertheless, the target for fiscal year 19 seems difficult to be achieved as FBR has only reached 67.7% (during 10 months of FY19) of the revised target of Rs. 4398 billion for tax collection of FY19.One of the significant reasons for this shortfall is that a substantial chunk of tax revenue had gone out of catch due to some politically motivated decisions. An apex court's decision also made its effect. Removal of taxes on mobile phone recharges, reduction in rate of income taxes and decline in petroleum levies in particular increased gap in tax collection.

Budget-making process becomes a difficult task in such deteriorating economic conditions. Consequently, the IMF bailout package which the government has opted for is attached with strict economic policy obligations required to be implemented in order to avail full loan of USD 6bn over a period of 39 months. Keeping these policy obligations in consideration while preparing the budget has increased the difficulty of the task. Thus pressures are evident in the approach of the economic managers involved in the making of the budget of FY2019-20.

Budget-making and the Chronic Ills of the Economy:

The budget lacks direction towards any long term planning; determination of fundamentals in this regard is inevitable to have sustainable economic development and attract private investment. The chronic dependence on debt for financing various types of expenses has not been addressed. In the last three years, the federal government has substantially relied on borrowing from the central bank on high rates of interest. The circular debt imbroglio also continues to add pressure on the economy. Public Sector Enterprises (PSEs) are posing serious concerns and contributing significantly in gigantic debt issue of the government. These factors eat-up major chunk of revenues forcing the government to borrow more and more for financing development and even non-development expenditure and the vicious cycle of debt expands. Another challenge in this regard is the continuing phenomenon of fiscal and current account deficit so much so that the interest payment of public debt now equals to 92% of fiscal deficit.

Reliance of revenue collection through high number and rates of indirect taxes, is also a chronic disease; it does not portray a sensible and economic and people-friendly policy. Government's increased reliance on indirect tax negatively impacts aggregate demand and widens the inequitable distribution of income. Indirect taxes also cause rise in inflation and to curb this SBP has raised policy rate to 12.25% ignoring the fact that current inflation is 'cost push' rather than 'demand pull' and it is going to hurt the investment environment.

While a number of reasons could be cited as the cause of the above mentioned ills, poor governance adhocism, and more importantly the political considerations in Budget-making and other economic related decisions at all levels in the country have historically been responsible for the vicious cycle we are in today. These deep rooted nuisances have remained core problems and are still hurting economy of Pakistan. Redressal requires a comprehensive long term strategy, and not just focusing on increasing tax rates in every budget. Moreover, 'one size fits all' can never be regarded as a prudent policy; indigenous solutions are needed by taking every stakeholder on board for long term and sustainable economic growth.

Budget 2019-20: Issues and Way Forward

- There is no doubt that the budget 2019-20 has been prepared considering the IMF program. While, IMF programs are always controversial in the country, particularly being not poor friendly, it may be justified in view of the worsening economic situation. Hence, there is a near-consensus among the economists that the government lost precious amount of time in approaching the IMF. The delay while caused further deterioration in the economic conditions also made the negotiations with IMF difficult for the country. However, the program is likely to improve the overall discipline and economic management of the country.

- Despite containment of civil, defense and development expenditures, the federal expenditure will increase by 28%. This is because of substantial increase in funds allocated for mark up on domestic debts and foreign loan repayments. Seen in this backdrop a positive initiative in the budget towards efforts of reduction of public debt in future, is announcement of ban on government borrowing from the central bank.

- As the two major crises faced by the country are fiscal and current account deficit, focus of the budget and other economic policy measures is shifted to these grounds rather than higher growth for the time being. Currently, the primary deficit is at 2.4% of total GDP whereas the policy obligations of IMF ask to reduce it to 0.6% during this year. This is a big challenge but looking at the budget measures serious efforts appear lacking in this regard. Hence, it is given that if quarterly reviews of the economy are not satisfactory, stricter policy obligations may be implemented. Similarly, current account deficit is also not seriously addressed, though imports are contained but on the other side exports have declined too. There is a strong need to focus and alter consumption patterns at every level of government and the society and therefore it should also be a part of social and educational agenda along with necessary economic measures.

- Current economic situation is not favorable for investment and manufacturing as production costs are increasing coupled with reduction in subsidies in energy which will also cause increase in cost of doing business. It is now time to consider innovative ideas and policy initiatives for involving private sector in provision and distribution of energy. The global experiences, including even in some neighboring counties in this regard stress to go for a shift from public sector to private sector in producing and providing the utilities. Large scale production and promotion of renewable energy sources will reduce burden on government expenditures.

- While PTI in his manifesto had committed not to privatize Public Sector Enterprises (PSEs)[2], it appears to have now altered its approach and has included Rs. 150 billion of revenue in Budget 2019-20 to be earned from privatization of PSEs. There is no doubt that privatization of PSEs is a sensitive subject since it involves a large number of employees working there besides other related issues. It however is to be realized and the nation needs to be educated that while the rights and privileges of PSEs' employees should be protected as much as possible, they are part of a nation of 220 million which is constantly facing the huge burden of their losses. A comprehensive approach by involving all stakeholders and evolving a political consensus is needed in this regard for both revival and privatization of SOEs.

- Current budget has not addressed SMEs and nothing significant is found on enhancement of total factor productivity which is tantamount to augmentation of economic development and reduction in unemployment. In such depressing economic environment serious attention should have been put on private sector investment which is significant

[2] Page 30-31, Chapter 4: Inclusive Economic Growth, PTI Manifesto 2018.

contributor of GDP and holds pivotal position in creation of jobs.

- Another area where PTI has deviated from its promises is that of rationalization of tax system[3]. In the current budget indirect taxes are not taken as an ill to be treated, rather more emphasis and reliance is put on indirect taxes to achieve an ambitious target of Rs.5555 billion tax collection out of which Rs. 3475 billion is proposed to come from indirect taxes (an increase of Rs. 1000 billion from previous year target) and Rs. 2081 billion from direct taxes which is Rs. 400 billion increase as compared to previous year. FBR reform was also a promise of PTI[4]. The institution is criticized a lot in context of not having capacity to fulfill its own proposed tax targets and therefore require significant reforms and capacity building. There is however no significant move seen until now from the government. Continued reliance on indirect tax is partly due to this reason as well. Amidst GDP growth rate of 3.3% and policy rate of 12.25% with contractionary fiscal policy, huge target of tax collection looks difficult to achieve.

- GDP growth for the next year (2019-20) is targeted at 4% against 3.3% this year. This is a modest target and should be achievable. The macroeconomic framework contained in the budget documents forecast it to reach 4.5% in (2021-22). This moderate scenario falls far short of PTIs commitment[5] and people's expectations, as lower growth rates of 3-4% are unable to create enough jobs for all the people and so level of unemployment will increase. It will further lower the already low social economic ranking of Pakistan in the comity of nations. Thus in the medium and long term perspective the issues needing effective attention are: higher sustained and inclusive (focusing on poor and disadvantaged groups) growth, raising national savings and investment, greater self-reliance, enhancing factor productivity and human development and welfare. Initiatives have been taken in the social sector by doubling funds for BISP and launching Ehsaas program. These are commendable measures but not enough to eradicate the poverty and trigger a sustainable process.

- The focus of the government policies should be diverted towards betterment of governance and distance political preferences from economic policies. Ambitious yet desirable initiatives are being announced in education, health, housing, employment, poverty and other fields. These may however be handicapped by lack of availability of financial resources and lack of management capacity to effectively implement them. Innovative and pragmatic approaches should be explored. It needs to be emphasized that resources are abundant but lack of confidence and trust among different economic stakeholders is needed to be enhanced by developing strong strategic communication narrative by the government. This would help in aligning all stakeholder with the positive efforts of government towards betterment of the economy.

Prepared by IPS Task Force

For queries: Syed Nadeem Farhat, Senior Research Officer, nadeem@ips.net.pk | www.ips.org.pk

[3] Page 26, Chapter 04 Inclusive Economic Growth, PTI Manifesto 2018.
[4] Ibid
[5] Page 27, Chapter 04 Inclusive Economic Growth, PTI Manifesto 2018.