Recommendations for the Federal Budget 2021-22

Policy Brief

The PTI-led government is all set to announce its third full-year budget on June 11, 2021. The recently appointed Finance Minister Shaukat Tarin has demonstrated positivity and hope in his stated objectives. He has said that it is time to move out of the stabilization phase to a period of sustained and inclusive growth, using a bottom-up approach. That will be a decent policy shift, and seems good-positioned given the overall decent state of macroeconomic indicators. A complete exit from neoliberal approach would certainly be imperative for materializing the dream of inclusive growth.

Current Economic Situation

Pakistan has managed the Covid-19 pandemic relatively well so far. From the 'smart lockdowns', stimulus package of Rs1.24 trillion, to a well-organized vaccination program, the government deserves to be commended for its mature efforts. As the country recovers from the third, and hopefully the last, wave of the disease, the economic report card for FY2020-21 is beginning to emerge. The economy grew by 3.94% in the current fiscal year, surpassing all expectations. The agriculture sector had historical production levels of major crops such as rice, wheat, and maize. Large-scale manufacturing (LSM) grew by 9.3% during 9MFY21, crossing the pre-Covid level. Services sector also showed a 4.4% growth, led by retail, wholesale, and financial sectors. How much of such an economic growth is pro-poor and inclusive is yet to be evaluated.

For July-April FY21, the current account posted a surplus of $773 million, owing to record remittances ($24.2 billion, growth of 29%) and stronger exports performance ($20.9 billion, growth of 13.6%). The remittances were partially buoyed by the Covid-19 effect due to which expats extended greater financial support to their families in Pakistan. The textile export sector benefitted from Covid-related lockdowns in exporting competitors such as India and Bangladesh. The sustainability of this trend would certainly depend on how the government gives a turn to its monetary and fiscal policies.

On the revenue side, FBR has collected Rs4.167 trillion in 11MFY21 and appears on track to achieve the revised revenue target of Rs4.7 trillion. While the collection is impressive considering the pandemic, its breakdown shows a heavy reliance of 65% on indirect taxation, which further hurts the inflation-stricken poor. The average CPI inflation during July-April FY21 was recorded at 8.6 percent, which is quite high, but is down from 11.2 percent from the same period in FY20. The main factors behind high inflation continue to be supply-sided rather than demand induced. That also brings into question the rationale behind high policy rates set by State Bank of Pakistan (SBP). The SBP has held the policy rate at 7% since June 2020, bringing it down from 13.25% owing to the recessionary pressures of the pandemic. Monetarist approach of Friedman would no longer work in Pakistan if the key idea is to have inclusive and sustainable growth. Policymakers need to think of a substantial cut in policy rate at least up to 5% so as to give a boost to business investment.

The fiscal balance was projected at -7.4% of GDP, but experts believe that it will end up being well above -

8%. The primary balance is likely to be -1% of GDP. Debt to GDP ratio stands at 87% whereas interest payments constituted 80% of net federal revenue of Rs3700 billion. The federal government has acute fiscal constraints and has to rely almost entirely on debt to finance its operations. The monetary idea of cutting the interest rate would offer relaxation to the government in the management of its domestic debts. Moreover, there is a need to cease financing projects that are in the provincial domain of post-18th Amendment, and to reduce the size and expenses of federal departments.

An intellectual look at ground realities is direly needed. On ground, not much has improved despite some decent economic indicators. High inflation has severely eroded purchasing power of the common citizen, and economic slowdown due to the pandemic has pushed millions into poverty. Non-inclusive growth pattern and reliance on regressive taxes have meant that economic inequalities have rapidly widened both across population and regions. The country still has about 19 million children who do not go to school, even though Article 25A of the Constitution makes the state responsible for providing free schooling to every child. Almost half of the population lacks access to clean drinking water. Electricity is expensive, despite some subsidization at the lower end. Exclusive urban growth has made it difficult for the young professionals and new families to find affordable accommodation close to employment opportunities. Good public transport is scarce and private vehicles are becoming increasingly unaffordable. Wages and salaries have remained relatively stagnant in real terms, and for a sole breadwinner to finance rent, food, education, health, transport, clothing, and energy needs out of a typical monthly pay is a backbreaking task. What is needed is not just growth, but sustainable and inclusive growth that uplifts the people on the lowest rungs. It inspires hope that the government intends to pursue this goal in the upcoming fiscal year and onwards. The policymakers should be conscious that neoliberal approach and the very idea of inclusive growth cannot go side by side. Both political and economic institutions should be operated in inclusive patterns rather than in extractive ways.

Government Projections and Needed Actions

The Medium-Term Budget Strategy Paper (MTBSP) spells out some encouraging objectives: pursuing sustainable and inclusive growth, broadening tax base and tax net, improving tax policy and administration, increasing the share of direct taxes, protecting vulnerable segments, controlling inflation and growth of circular debt, only implementing minimal increases in current spending, and mitigating the impact of Covid-19, among others. The government intends to give special attention to the construction, agriculture, energy, and IT sectors as well.

Taxation and Revenue

For FY22, the government is targeting a revenue of Rs5.8 trillion. An increase of roughly 24% over the current target, there is a justified concern that such an ambitious target may be pursued without addressing the structural deficiencies of the tax administration and broadening the tax base. That would not only stifle investment and growth, but also further hurt the existing tax payers and further reduce trust in government. The targeted economic growth rate of 4.8% will only provide some increase in revenues given the low tax buoyancy of Pakistan. Most of the increase will have to come from administrative measures such as broadening the tax base and withdrawing tax exemptions. There has always been a lack of political will to tax the influential elites, and that trend needs to change if tax revenues have to be increased in a progressive manner. The finance minister did mention that the salaried class will not be burdened with tax increases and that innovative means will be used while bringing traders into the tax net and prosecuting tax evaders.

There is no denying the fact that most of our imports are inelastic. This is an implicit kind of hurdle in the way of inclusive growth. A cap on the import of luxury cars, cosmetic, edibles, and cell phones may give a great boost to the economy. The net potential of stopping unnecessary imports is significantly higher than the revenue being generated from such imports. As for instance, our imports from China have substantially increased for the last six years as compared to what we export over there. Public policies should be framed in such a way that terms of trade could be shifted towards Pakistan. Without promoting local manufacturers, the targets of inclusive growth cannot be achieved.

Development Sector

The federal PSDP is being increased by 38% to Rs900 billion from the current Rs650 billion. The mid-year review (July-December FY21) showed only 34% of

PSDP being spent. Adding another quarter, and the government was unable to spend 40% of the development budget in 9MFY21. Pakistan is very weak in the implementation of budgetary estimates. The common practice of revised estimate is not fairly transparent. The subsequent budgetary manipulations are hardly made public. There is an incredible backlog of ongoing projects that spreads the resources too thin and discourages new initiatives. It needs to be asked how the government plans to tackle these constraints. The throw-forward of PSDP should be contained by imposing a temporary moratorium on new projects, completing the existing projects and shelving projects not making any progress. Furthermore, the confidence of public administrators needs to be restored by avoiding unnecessary probing and only initiating investigations based on substantial intelligence reports.

Agriculture Sector

Agricultural sector, one of the great contributors to our GDP, needs special focus as it is the perfect conduit for the uplift of people in rural regions that have been left largely neglected. The key focus should be on production and productivity. Better agricultural incomes would also curb the rapid urbanization that is choking major cities. The finance minister has already hinted at some innovative agricultural reforms. Farmers need to be provided cheaper fertilizer and electricity so that their margins may improve. There is a need for agricultural research funding in order to develop local and high-yielding seeds for wheat, cotton and other crops. The irrational dissemination of subsidies need to be revisited for enhancing economic efficiencies. The government needs to actively teach farmers how to add value to their products, so that better returns and terms of trade can be achieved. Special regulatory mechanism need to be strengthened for curtailing market distortions and subsequent inefficiencies. Livestock needs to be improved for better yields and incentives should be given for setting up milk processing plants. Farmers need to be given better access to wholesale markets. There is also immense potential in the blue economy. Productive agricultural reforms will also improve food security, in which Pakistan ranks 80/113 in the Global Food Security Index.

Defence Sector

The current situation in Pakistan poses a challenge to Pakistan's security. Therefore, no compromise can be made for the defense of the country. The defense budget, being an important part of our country's security, should be drawn from every budget of the country. Therefore, the Government needs to rationalize the Defence budget. There shall be no compromise on the combat budget of the country but rationalization needs to be done for the non-combat budget.

Circular Debt

A major drain on public resources is circular debt, particularly in the energy sector. Circular debt amid high capacity payments in the energy sector are above Rs1 trillion currently, and the government is forced to increase energy tariffs to recover some of that from paying consumers. The exponential growth of circular debt needs to be arrested immediately otherwise it may spiral out of control. Furthermore, transmission and distribution losses are around 20%, which are almost double the global average. Negotiations with IPPs should continue until a relative parity between IPPs and the government is achieved. On the other hand, there is a need to upgrade the inefficient transmission system and loss-making distribution companies. The government should also look to liberalize the energy sector so that competition can make it more efficient. Cheaper sources of energy generation have to be integrated within the energy mix to lower the basket price, and focus has to be put into competitiveness of generation, transmission and distribution business. Bringing public private partnerships and investments into the sector can reform market orientations.

IT Sector

The importance of IT sector is being rightfully emphasized, as it has immense potential for raising exports and generating jobs for the tech-savvy youth. E-commerce and freelancing have seen a boom during the pandemic. One need to look at the generous policies of Alibaba and Amazon. Moreover, IT has become a common medium of education, especially during the pandemic. During the eight months of current fiscal year, IT exports reached $1.3 trillion, an increase of 41.4% over last year's corresponding period. The export surge is partially due to the Covid-19 lockdowns and a favorable exchange rate. Pakistan's youth bulge can be provided ample employment if the IT infrastructure is developed and investments in IT are encouraged. Tax policy on IT hardware such as cell phones, laptops, and IT sector as

a whole, needs to be accommodative until the sector matures. Internet penetration should be encouraged by making cheap and fast internet accessible to all. Hurdles in installing fiber optic cables, such as government NOCs and passage rights, need to be removed. Internet connectivity should be seen as a basic necessity in today's world that is undergoing the Fourth Industrial Revolution.

COVID-19 Vaccination

Finally, successful vaccination of a major part of the population is critical to resume normal economic activity and expedite Pakistan's re-entry into global value chains. The good news is that Pakistan has allocated $1 billion for vaccine procurement. The rightly applauded vaccination program needs to be expanded to more regions and it is essential to remove people's fears and misconceptions regarding Covid-19 vaccines. Pakistan has an estimated adult population of around 130 million out of which about 6 million (4%) have been given at least one dose of vaccine. Pakistan will receive only 17.2 million vaccine doses through the global vaccine sharing program, Covax. Manufacturing of the locally-produced PakVac vaccine, with the help of China's CanSino, should be scaled up, and the rest of the vaccines should be procured from the market for which significant budgetary outlays are required.

At this juncture of history, Pakistan may become an attractive and potential hub of business if we are able to design our budgetary estimates on a rational pattern and thus formulate allied public policies on inclusive fashion rather than the traditional extractive ways. Business and investment potential is there, which could be reaped if economic management of resources is pursued through an appropriate fiscal-monetary policy mix. The government should take bold steps to stop unnecessary subsidies that often cause inefficiencies. Incentivizing hidden mafias and vested interest groups can never be helpful in achieving inclusive and sustainable economic growth.

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