Federal Budget of Pakistan’s Roller-Coaster Economy

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A detailed Report

Overview of the Budget of Pakistan

Introduction

In Pakistan, the general budget is known as the Federal Budget. In the Constitution, it is referred to as the Annual Budget Statement (ABS), prepared and presented by the Federal government before the National Assembly (lower house) every year. It is a statement of the estimated receipts and expenditure of the Federal government in a particular financial year. The financial year starts on 1st July and ends on 30th June. The Constitution underlines that all receipts and expenditure to be incurred in a particular financial year are to be met by the Federal Consolidated Fund (FCF) of Pakistan. All revenues received, all loans raised, and all moneys received by the Federal Government form the FCF. Besides the fund, there is also another account of government known as Public Account of the Federation (PAF). In this account, all other moneys received by or on behalf of the federal government; or received by or deposited with the Supreme Court of Pakistan or any other court established under the authority of the federation gets credited.

The custody of both the FCF and PAF is governed and regulated by the Act of Parliament (Majlis-e-Shoora). The ABS derive the required sums for a particular financial year from the federal consolidated fund under the categories of 'Charged' expenditure and 'Other' /voted expenditure. Whereas the 'Charged' expenditures are not subject to voting in Pakistan Parliament and remains beyond legislative scrutiny; 'Other' expenditures are submitted to vote in the National assembly and hence are subject to legislative enquiry. However, nothing can prevent the members of parliament to discuss the expenditure made under the charged category. Charged expenditure in the federal budget is also known as 'Authorised Expenditure' which gets authenticated by the Prime Minister of Pakistan and introduced in the Parliament of Pakistan. 'Charged' expenditures is predominately related to constitutional functionaries and offices and therefore meant to maintain their administrative as well as functional autonomy. These includes the salaries payable to the President and other disbursement relating to his office; the salaries payable to the Judges of the Supreme Court, the Chief Election Commissioner, the Chairman and the Deputy Chairman, the Speaker and the Deputy Speaker of the National Assembly, the Auditor-General; and other administrative expenses including the remuneration payable to officers and servants of the Supreme Court, the Department of the Auditor-General, the Office of the Chief Election Commissioner and of the Election Commission, and the Secretariats of the Senate and the National Assembly. Besides, there are other committed liabilities of the government such as debt servicing, interest payments, the repayment or amortization of capital, and other expenditure in connection with the raising of loans, which have been made on the security of the FCF.

Structure of Pakistan Budget

The Federal Budget in the country comprises of Revenue Budget and Capital Budget. While the Revenue Budget is constituted by both Revenue Receipts as well as the Current/Non-development Expenditures; the Capital Budget comprises both Capital Receipts and Developmental Expenditure. The distinction between revenue budget and capital budget is inconsequential and they complement each other in the expenditure budgeting process. To comprehend the structure of the budget, it is also imperative to further classify the budget on the lines of expenditures and receipts. Current and Developmental Expenditure: The distinction between Current/Non-developmental and Developmental Expenditure is significance one. These two forms together the total budgetary expenditure of the federal budget. The Current expenditures are for day-to-day recurring expenditures or non-developmental expenditures of the government. This includes, among others, the General Public Services such as maintaining administrative, executive and legislative organs of the country, servicing of foreign debt, foreign loan repayment and servicing of domestic debt, maintaining national defence and public affairs of the country. More importantly, it also includes various areas of economic affairs (agriculture and its allied activities, energy, mining & manufacturing, transport and communication); environment protection (water waste management); housing and community amenities, health and education, etc. The outlays for current expenditure are met through revenue budget. If revenue receipts are greater than the current and non-development expenditures, the surplus amount is transferred to Capital Budget to meet the developmental expenditure. If revenue receipts are less than the current expenditures, the government has to meet the deficits through borrowings. Ministry of Finance plays very crucial role in making of current expenditure in Pakistan. Developmental Expenditure is the expenditure meant to keep intact, enlarge and to improve the physical resources; improve the knowledge, skills and productivity of the people; and encourage efficiency with which the available resources are used. The developmental budget is designed to create material assets which add to the economic potential of the country. It essentially involves construction of a work or acquisition of a permanent asset of public utility through Public Sector Development Programme (PSDP). With ever increasing investment to promote economic development, the capital budget is assuming increasing importance. The developmental expenditure is also called as capital expenditure. The capital expenditure is generally met from the revenue surplus, reserve funds and borrowing for specific or general purpose. Provision for development expenditure is included in the budget on the basis of the Annual Development Programme (ADP) prepared by the Planning Commission in consultation with the Ministry of Finance and the Provincial Governments and approved by the National Economic Council.

Resource Mobilisation:

After determining the priority and quantum of expenditure under different heads, the government work out the mobilisation and estimation of resources to meet the expenditure needs. The resource mobilisation is done through two sources-Internal Receipts and External Receipts.

Internal Receipts:

The internal resources come through Revenue Receipts (tax & non-tax), net Capital Receipts, financing of PSDP by the provinces and change in the provincial cash balance. Revenue Receipts is further divided into Principal Heads of Tax Revenue- (Direct Taxes and Indirect Taxes and Surcharges), and Other Head of Revenue (NonTax Revenue)-the Income from Property and Enterprises, receipts from Civil Administration and miscellaneous. Net Revenue Receipts (NRR) can be obtained by deducting ‘Transfer to Provinces’ from Revenue Receipts. Capital Receipts on the other hand are intended to plug the gap of revenue deficit through internal resources--Permanent Debt, Floating Debt and also recoveries of Loans and Advances. Importantly, saving schemes, G.P. Fund and other deposits at the Public Account of the federation also form part of the capital receipts. Net Capital Receipts (NCR), can be obtained when capital disbursement is deducted from the capital receipts. Capital disbursements are those disbursements in which the government makes some investments or provides loans and advances and makes short-term credits both internally and externally.

External Receipts:

External resources/ receipts come from foreign loans and grants. The external borrowing is called for to meet the shortfall in the estimation of internal receipts. External resources mainly comprise (i) loans and credits from friendly countries and specialized international agencies and (ii) grant assistance under specific country programmes. The Foreign Aid (Loans, Credits and Grants) is broadly categorized as project aid, commodity aid and other aid. Project aid generally takes the shape of foreign loans and grants for procurement of project equipment and supply of services etc. Commodity aid is utilized for commercial imports. Goods imported under this aid are generally industrial raw materials, equipment, consumer goods, chemicals, fertilizers and such other commodities as may be specified or generally agreed to or, if the aid is untied, as the country may actually need. Commodity aid also helps to generate rupee funds which augment the country's rupee resources to meet its development needs. The assistance under "Other Aid" comprises loans and grants from non-traditional sources generally by way of balance of payment support.

Budget Cycle:

The budget is technically the document that includes the government's expenditure and revenue proposals, reflecting its policy priorities and fiscal targets. However, the budget document is the culmination of an on-going budget decision-making process, and of a country's system for managing and assessing its spending and tax policies. Looking at any one aspect of the overall budget system in isolation misses the important interaction between the various parts. Therefore, a discussion on the budget cycle is imperative. The Budget Cycle consists of the major events or stages in making decisions about the budget and implementing and assessing those decisions. The budget cycle usually has four stages:

- Budget formulation, when the budget plan is put together by the executive branch of government;
- Enactment, when the budget plan may be debated, altered, and approved by the legislative branch;
- Execution, when the policies of the budget are carried out by the government; and
- Auditing and assessment, when the actual expenditures of the budget are accounted for and assessed for effectiveness.

Budget Calendar of Federal Budget in Pakistan

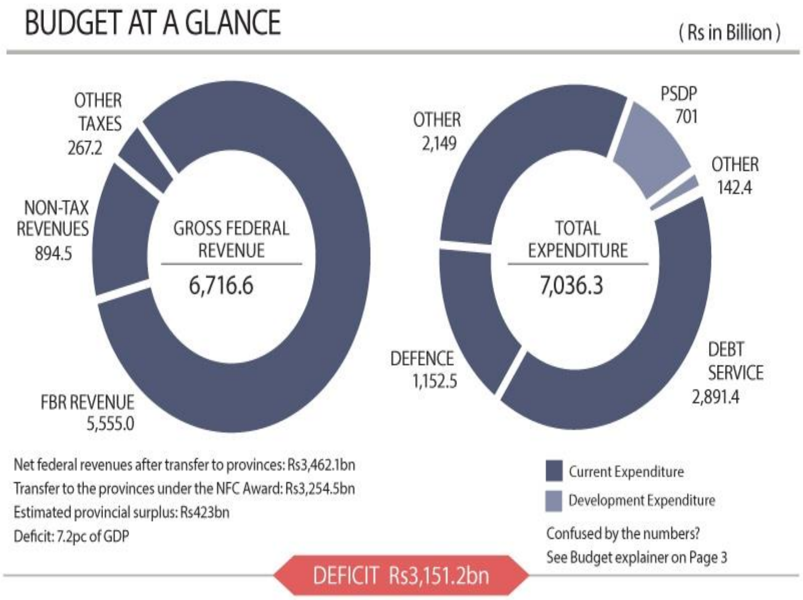
Budget Call Circular	August-October
Budget Estimation	November-January
Detailed scrutiny by Controlling Officers	November – December
Detailed scrutiny by Finance Department	January- February

Formulation of Budget proposals by Finance Department	April
Federal Cabinet approval	May/June
Budget in Federal Assembly	June
Authentication of the schedule of approved expenditure by Parliament	June
Funds release by Finance department	July

Source: Budget Tracking Manual (A tool of Community Empowerment), Human Rights Commission of Pakistan, Lahore, 2005.

Highlights of Budget 2019-20

Budget of 2019-20



Taxes on commodities of daily use have been increased, exemptions on the import of LNG have been removed, tax exemptions on the current exporting industries have been done away with and tax exemptions for the salaried class have been reversed in federal budget of 2019-20. The most immediate and visible consequence of this package can be seen is the erosion of the purchasing power of the common man. On a macro level, with the removal of exemptions for LNG and given our current exporting industries, the cost of production has increased, making our goods less competitive in the global market.

The budget has focused on some aspects of the critical interventions needed to boost the economy, but there are glaring contradictions as well. Attending to IMF conditions, a one-time sacrifice of the defence budget's increment, more income tax slabs and higher sales taxes are temporary measures to provide breathing space to help avert a current fiscal crisis. The government is still committing to a high fiscal deficit at 7.1 per cent compared to 7.2pc of GDP in the last year, owing primarily due to the large size of the debt repayments. In addition, the government has announced highly challenging revenue targets in a low-growth period, relying mostly on taxes to be collected from the masses. This is despite a recent World Bank report confirming that Pakistan is capturing only half of its revenue potential and needs to raise revenues by enhancing tax compliance — not levying new taxes or increasing rates. What we can expect before the next budget, in the face of an economic slowdown, is higher inflation and a tighter job market as economic activity takes a hit. Some of this inflation could be offset if income taxes were lowered, but that is not the case as Pakistan sets its sights to grow tax revenues at the fastest pace in recent years. With less than 1pc of 208 million people filing returns, it may be difficult to meet the ambitious revenue targets. While a slow-down in the demand for imports will help to prevent the dollar drain and reduce the trade gap, and higher taxes along with spending cuts can help reduce the budget deficit, the government may save enough to spend on development projects. But this process will take time. It may take two years before economic growth can bounce back and the government is able to fix the larger macroeconomic problems. If not, then we could be looking at another bailout.

There are three adverse consequences of this budget which we need to look at over the coming year:

The impact of increased taxation on people's spending capacity — for example, a person making Rs50,000 a month will have to pay income tax, along with exposure to the broader impact of inflation due to the devaluation of the rupee and increase in sales taxes.

The dramatic decrease in higher education spending (via the PSDP) have a significant impact on the quality of universities and research. This might be the single worst choice made by the government in this budget.

The budget has allowed non-tax filers to purchase property worth Rs5 million or more. This would have pushed people to move capital towards the non-tradable sector — an incredibly bad incentive for people to move capital away from productive sectors.

Budget 20-21 Essential Reforms

For the last many decades, the main emphasis of every budget has been meaningless and cumbersome changes in the existing outdated, oppressive and anti-growth tax system, which itself is the root cause of major fiscal ills. It is strange and shocking that we want to reform a system that needs to be dismantled in entirety and should be replaced with all together a new one. Reforming the incorrigible is a futile and Sisyphean task. Unfortunately, successive governments-military and civilian alike-have been ignoring or sidetracking fundamental institutional reforms to achieve a higher rate of investment and growth and make the tax system simple, predictable, fair and equitable. It is a golden opportunity for the current Government of Pakistan to undertake institutional reforms to win the support of masses. All the previous governments have failed to tackle the most essential issues of ensuring ease of doing business, reducing cost of doing business, accelerate growth, induce and boost investment, concentrate on human skills, tap resources, generate employment, and deconstruct the unproductive tax system which imposes high taxes, but yields low revenues. A system that is operationally inefficient, anti-business, complex, time-consuming and costly. Even after imposing all kinds of oppressive taxes and tall claims of "extraordinary" performance, revenues are still below the real potential, which is not less than Rs 10 trillion at federal and provincial levels.

The government must be reminded that no agenda for rationalisation of tax codes or simplification of tax system can improve tax compliance, unless there is substantial improvement in public perception regarding the efficiency, technical competence, integrity and ability of the tax authorities to relentlessly pursue and punish tax evaders without any political and other interference. The present functional structure in Inland Revenue Service (IRS) has failed to achieve these objectives. While there is always talk of giving "market" wages to tax officials, nobody has ever emphasised having a national tax agency by improving the overall working conditions and professional skills of officers and staff. If one goes to a tax office as a taxpayer only then one would feel the taste of inhuman and insulting treatment, an ordinary citizen receives daily. Does it really need enormous money or funding from World Bank and foreign donors to extend the well-deserved respect and courtesy to taxpayers? Does this issue relate to market wages or foreign funding or advice?

The fundamental element of tax reforms is providing a simple tax system that is manned by an efficient and competent administration, which is nowhere visible in Pakistan. Tax administrations, both at federal and provincial levels, lack the requisite level of digitization, professionalism and human skills. Any exercise relating to comprehensive tax reforms cannot be a time-bound affair and does not mean merely altering tax laws or suggesting cosmetic changes here and there. Reforms can be successful only if comprehensive analysis is made of the whole system, that is, tax structure, tax administration, state of economy, taxpayers' attitude, revenue needs of the country and many other allied aspects.The best example of an efficient tax structure is that of Sweden's tax agency, Skatteverket that maintains data of each and every person, natural or juridical. Skatteverket is accountable to the government but operates as an autonomous public authority. We need to establish National Tax Authority (NTA). This kind of innovation alone can counter massive pilferages in collections that were estimated at Rs 3 trillion by IMF in its country report of 2016, Unlocking Pakistan's Revenue Potential. The existing tax system is not taxing the rich 5 million. Resultantly, income and wealth distribution disparities are rapidly widening. Under the given scenario, efforts are needed both at federal and provincial levels to enhance the size of the pie by shifting to growth-oriented taxation.

Historically, budgetary allocation to women-only programs has been low everywhere in the world. Even those countries which have initiated gender auditing of the budget have allocated only one or two percent of the budget to women specific programs. Pakistan’s case is similar from this perspective. Of the total services related budget for 2005-06, women specific expenditures are only Rs. 6.7 billion or 1 percent of services related budget. In contrast, men specific expenditures are only 0.1 percent of the services related expenditures. Gender aspects must be improved in this budget.

Drawbacks

In Pakistan, there are four serious flaws in the process of preparing, passing and implementing the annual budget in the assemblies, both at the federal and provincial level. First and foremost is the absence of a public finance management law which governs the budget process.

Despite the passage of many years since the adoption of the Constitution, parliament has simply failed to pass a public finance management act, and as a result, all these extremely important functions are regulated under an ad hoc arrangement by the executive as it deems fit. A government in power commanding the majority in the National Assembly feels that the absence of a public finance management act gives it the unbridled power to regulate the federal consolidated fund and related matters, and therefore, it takes no initiative to legislate on this important area of state business.

The second and probably the most serious flaw in our budget process is the constitutional provision which gives almost unlimited power to the executive to alter the budget even after it is passed by the National Assembly. Article 84 of the Constitution provides for 'Supplementary and Excess Grants' which the federal government has the power to authorise without prior approval of the Assembly. This alteration in the budget is then reported to the Assembly in the form of a 'supplementary budget statement' at the end of the financial year when the next year's budget is presented in the Assembly. The latter, at that point, has little option but to pass the supplementary budget as the expenditure has already been incurred.

There are many instances where a government has started the process of altering the budget soon after its passage. This provision seems to be unique to our Constitution and only Bangladesh has inherited it. Our research indicates that no other country has this unique provision to give powers to play with the budget approved by the Assembly. Denmark has an emergency provision under which the government can alter the approved budget but only after obtaining approval from the parliamentary committee on finance. Pakistan has such a committee, but it is kept out of the entire budget process and has no role in approving the supplementary budget.

One can understand that there may be instances when a government genuinely needs to alter the budget but then the governments go back to parliament to seek its approval for the alteration. Pakistan has the dubious distinction of not considering prior approval of parliament necessary for amending the approved budget. It is surprising how Pakistani parliamentarians can live with a situation where one of their most important powers to authorise finances is compromised. A new public finance management law is, therefore, badly needed to correct this historic wrong and amend Article 84.

Third, although the National Assembly has to bear the burden of passing the annual budget with recommendations received from the Senate, the process of debating and passing the budget gives the impression of non-seriousness. The total duration of the budget debate is too short to allow any meaningful study, analysis and debate on such a serious issue as the annual budget. The average duration of the budget debate in the past years has been around 12 days consuming about 40 working hours. In a house of 342, this duration is obviously too short for a serious business such as the budget to be transacted. This is the reason that members of the National Assembly have little incentive to prepare for and engage in a serious budget debate.

And last, unlike other legislations that normally have to be referred to the concerned parliamentary committees for detailed scrutiny, the finance bill is not referred to any committee. The budget is also not seen by any committee and therefore an in-depth review of it is not possible.

Suggestions

- Pakistan's tax-to-GDP ratio is only 11 per cent, one of the lowest in the world. Countries with similar levels of development have ratios around 15 per cent. The main problem is that Pakistan's current tax policy assumes that the government has both good information on the tax base and the capacity to collect taxes at little cost. Moreover, it should bring the informal economy into the tax bracket. Since small scale informal sector is engaged in unrecorded or undocumented economic activity and hence remains unregulated and untaxed. This sector ends up using resources from other sectors and not paying back. They need to be taxed.
- Federal Cabinet has approved National Tariff Policy 2019-24 to be implemented in a period of five years starting from the Budget 2020-21. It would remain a formidable challenge finding a balance between revenue considerations and protections of local industry.
- It should Review the tariff structure. During the last decade, all the 20 fastest export growth economies have reduced import tariffs whereas Pakistan has opted the opposite path with an increase of 11% in import tariffs. As per World Bank report, Pakistan currently maintains the highest average weighted tariffs amongst the 70 countries having more than US$ 20 billion annual exports. Pakistan's weighted average mean tariff of 12.7% whereas top 70 exporting nations is 2.7%, global average 2.6%, South Asian average 5.9%, ASEAN average 2.5%, China 3.8% and India's 5.8%
- Pakistan should open its economy to the rest of the world by lowering restrictions on imports and signing new free trade agreements (FTAs) to enhance exports. For instance, Pakistan does not have an FTA with the US since it is one of the major export partners of Pakistan and has approximately 16.7% share in total exports.
- The rising expenses and the rising deficit might force the economy to move towards foreign funding as the deficit also impacts the exchange rate and the local currency gets depreciated. The funding from the external agencies will have an adverse effect on the credit rating of the economy. The low rating puts the economy in an undesirable situation as no venture will come and invest in such economy. Pakistan should reduce import tariffs and remove exchange restrictions to open the economy.
- Contracting demand and dampened exports are likely to lull us back in the negative feedback loop that follows every major IMF bailout. And this is what Pakistan's economy needs to structurally avoid if we are to disentangle it from international dependencies. To meet our revenue targets, we not only need to restructure the tax regime, but couple this with structural reforms that provide the right incentives for higher tax collection by increasing operational capacity.
- The past few decades Pakistan had been seeing a trend growth rate of 5 and 6 percent per annum growth, which has now plummeted to around 3 percent. Government should be looking towards a growth rate of 8 – 9 percent.

- Large-scale manufacturing (LSM) is still not growing. LSM output showed a year-on-year decline of 5.93%. The LSM growth target should be equivalent or greater than 1.3% for the current fiscal year

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