

PROF. DR. EHSAN RASHID MEMORIAL LECTURES

CURRENT FISCAL ISSUES IN PAKISTAN: In light the Budget 2015-16**

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Discussing the Current Fiscal Issues of Pakistan we first need to consider the Federal Budget 2015-16, presented in the National Assembly on 5th June 2015. It may be noted that the ‘focus of the budget is not on growth; but it is rather on reducing the fiscal deficit’. The total budget is worth Rs.4.451 trillion, which is allocated for the current government activities by focusing on the economic growth and attracting foreign investment in the country, whereas, the budget also focus on the stabilization policy. Although, the common man point of view of the Budget does not provide a relief to the masses, because relief measures which are given in it for common citizen is not really up to the mark.

Following points are presented for the policy makers, which need their attention to address the Fiscal Issues of Pakistan:

1. How to Raise the Tax to GDP Ratio.
2. The Level of Security – Related Expenditure.
3. Power Sector Subsidy.
4. Management of Public Debt.
5. Size of the PSDP and Development Priorities.
6. Fiscal Federalism and Decentralization Issues.

These fiscal issues of the Budget’s (2015-16) are elaborated below:

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1. Tax to GDP Ratio

First we need to look at the numbers/figures of the trend in the tax revenue, the tax gap and the magnitude of tax expenditure which enable us to understand the scenario.

- ***The Trend in Tax Revenue***

The trend in tax revenue during the past few years can be highlighted year-wise as percentage of the GDP. For the fiscal year 2010-11 the FBR was 8.1 per cent whereas, overall it was 9.3 per cent, and then during fiscal year 2011-12 it was raised by 9.5 per cent and the overall it was raised to 10.4 per cent which show a slight increase in FBR. During the fiscal year 2012-13 there was a decline in both the FBR and the overall, i.e., 8.7 per cent and 9.8 per cent respectively. Again, during 2013-14 the FBR and the overall percentages started to increase and were 9.8 per cent and 10.2 respectively; and in 2014-15 the FBR and the overall percentages rose to 9.6 per cent and 10.7 per cent respectively.

These figure shows the extent of stabilization is to be achieved by the economy of Pakistan and it is recommended that to meet targets of realistic progress, we should now switch over from the stabilization mode to revival of the Pakistan's economy. However, during all these years, the share of Direct Taxes remained over 35 per cent.

- ***The Tax Gap***

The tax gap of the Bottom-up Approach and the Representative Tax System Approach were 6.8 per cent and 4.6 per cent of GDP, respectively.

- ***The Magnitude of Tax Expenditure***

The magnitude of tax expenditure (Evasion) was 3 per cent of GDP which was consistent with estimates of informal economy. According to Pakistan Economic Survey (PES) it was 2.4 per cent but according to my estimation it was 2.7 of GDP 2.5 per cent indirect Tax (12×0.25).

The present government is making efforts to stabilize the economy, since last two and a half years by emphasizing on power sector which is in process under the support and persuasion of the IMF program from the 'external fund facility'. Under this program following steps have been taken since 2014-15 to achieve stabilization. Tax mobilization strategy adopted by the government in 2014-15 is being followed by putting heavier emphasize on indirect taxes:

- The GST tax was increased from 16 per cent to 17 per cent which shows 1 per cent increase in the standards GST and increase in the minimum tax on companies from half-to-one. Therefore, this 1 per cent increase in GST tax has focused increase in all other sales taxes on services and other commodities which are already being taxed.

- The Self Regulatory Organizations (SROs) and the Tariff Reforms were considered by removing them from the tax bar.
- The minimum import duty has been introduced and applied by government in the budget 2014-15.
- There has been a big hike in GST on the petroleum products.
- 7 per cent on regulatory duty on furnace oil has been levied.
- Excise duty on cigarettes and similar items has been imposed.

Due to the above mentioned steps which were taken by PML(N) government (2014-15), the tax system became more regressive; as tax to GDP ratio was increased by 0.5 per cent of the GDP in 2013-14. The further increase in tax to GDP ratio by 1 per cent in the budget of 2015-16 will exert more pressure on the former taxed figures. Considering the power side, the past increase in tariff has helped to reduce subsidy by the government. In addition, the combined Public Sector Development Programs (PSDP) of the Federal and Provincial governments was cut by 25 per cent to meet the deficit target of 5.5 per cent in 2013-14.

What should be the Strategy?

To adopt strategies to overcome the current fiscal issues in Pakistan, the direct and indirect taxes should be controlled. Some of the measures are given as under:

- ***Direct Taxes***

To increase the tax growth the tax expenditures including sub-provincial regions (SRPS) should be disinterested and corporate tax evasion should be focused on. Global income should be included in tax category and transfer pricing should be kept low. In addition, there should be development in the capital gain tax.

- ***Indirect Taxes***

There should be evaluation of GST as VAT as there is need to complete the process of removal of self regulatory organizations (SROs) for further tax reforms. In addition, The broad-base excise duty is recommended.

2. The Rise in Security Expenditure

In the Budget 2015-16 over one trillion (i.e., 4 to 4.5 per cent) of the GDP has been allocated to increase the security expenditure. These expenditures were mainly due to sharp increase in the police force expenditures, war against terrorism (Zarb-e-Azb), and the Coalition Support Fund (CSF); implementation of the National Action Plan. In addition, Rs.100 million has been allocated for Temporary Displacement Peoples (TDPs). However, my opinion is that Super Tax should have been spread wider for the TDPs.

3. Management of the Public Debt

In the last year's Budget 2014-15 Rs.1,500 billion plus outstanding public debt of Rs.16 trillions were allocated for management of the public debt; but in the present Budget 2015-16 it is at the ratio of 64 per cent of GDP that fell from 65.6 per cent at which it was in the last year. In addition, per head public debt is Rs.91,000 in the Federal Budget 2015-16.

It has been noticed that in the current Budget (2015-16) the FR and DL acts have been violated, due to adoption of wrong debt management's bulk policies through PIBs (79 per cent of incremental DD). There is no increase in debt servicing in the Budget 2015-16 as high cost external borrowing was avoided; while during the last five years, the debt servicing was Rs.642 billion in 2009-10 and Rs.1270 billion in 2014-15.

4. The Size of Public Sector Development Programs (PSDP)

The Government aims to keep the size of PSDF to about 20 per cent of the public expenditure in the Federal Budget 2015-16. The GDP in 2014-15 was 3.3 per cent and in the Budget 2015-16 it is allocated as 5 per cent; whereas, its peak level was observed at 5 per cent in 2006-07. The utilization of public expenditure in 2014-15 was Rs.425 billion; whereas, Rs.125 billion out of Rs.700 billion was not the development spending. The allocations of public expenditure in the Federal Budget of 2015-16 are as under:

- Development in power structure is the main priority of the government, to improve power generation in the whole Pakistan. The Budget 2015-16 has reserved Rs.112 billion for WAPDA (power sector). This allocation is an increase by 16 per cent over the last year's reserves for power sector.
- Federal Budget of 2015-16 has been reserved (Rs.159 billion) for NHA which is an increase by 23 per cent.
- Rs.30 billion has been kept for WAPDA (water) though it is a decrease by 4 per cent in the current Budget (2015-16).
- The government in the Budget 2015-16 has allocated Rs.30 billion for PAE though it is a decrease by 4 per cent over the previous year's figures.
- Railways are the cheapest mode of travel for common man of the country. Therefore, Rs. 41 billion with an increase by 6 per cent has been allocated to this sector, in the current budget.
- Though the government hospitals and dispensaries are essential to provide health care to poor citizens but in spite of this fact, the government has decreased their budget by 3 per cent and reserved only Rs.21 billion for health programmes.
- Though the higher education is important for economy of the Pakistan, but this budget has also been curtailed by 3 per cent and only Rs.20 billion have been reserved for the HEC.

- In addition to the above, it may also be noted that over Rs.800 billion is kept for new priorities, which has been allocated for power sector.

5. Review of Provincial Governments

Review of Provincial Governments budget for 2015-16 is now discussed in the following manners:

- a) Enhancement in the size and role of Provincial Governments budgets.
 - i) Additional Transfer by 7th NFC Award (50 per cent to 57.5 per cent).
 - ii) 18th Amendment (Ablution of the Concurrent list).
 - 40:60 in the current expenditure on service excluding debt servicing.
 - 55:45 was fixed in the PSDP.
 - Human capital formation for industry.
 - Agriculture for agro-based industry.
 - Cost of doing business is being enhanced by interaction with financial entities.

6. Expectations of the 7th NFC Award.

Expectations of the 7th NFC award are as under:

- ***Horizontal Formula***

Due to horizontal criteria which move beyond the relative populations of the four provinces, the 7th NFC had certain degree of fiscal equalization. Resultantly, the small provinces like Balochistan and Khyber Pukhtunkhwa benefitted, while the share of Punjab decreased; however still the Punjab received more as compare to previous award.

- ***Much bigger Transfers to the Provinces***

The 7th NFC Award was much bigger for transfers to the province because of tax to GDP ratio -9 per cent → 15 per cent of GDP, actually marginalized to above 10 per cent.

- ***Incremental Fiscal Efforts by the Provinces***

There was an increment in fiscal efforts by Provinces in the after income tax (AIT) and real estate taxes in the 7th NFC Award.

- ***Big Increase in Outlays on Social Sector***

In the 7th NFC Award almost 4 per cent of the GDP increased in outlay of social sector which rose by 2 per cent of GDP and that is a breakthrough.

7. Actual Outcome of the 7th NFC Award

The actual outcomes of the 7th NFC Award are as under:

- No changes were made in the tax-to-GDP ratio as it remained at the previous slab of 10 per cent of GDP.
- There was a shortfall in transfer of over Rs.1,000/- billion.
- Provincial Efforts were limited to 0.4 → 0.7 per cent of the GDP.
- There was an over shortfall in development spending of Rs.1,200/- billion.
- Additional allocation to Social Sector were of 0.5 per cent of GDP (Rs.100 billion), wherein for Education 1.8 per cent → 2.1 per cent of the GDP were kept and for Health 0.5 per cent → 0.7 per cent of GDP were allocated.
- Extremely disappointing the Outcome was fall in social indicators in 2013-14 which were: LR -2 per cent, PE-0 per cent, DW -2 per cent and IR -6 per cent. Though, little progress has been made over the past 5 years, which was 1, 0, -2,-10, respectively, while more progress in the pre-NFC period, such as LR 4 vs 1 and NER 5 vs 1.

8. Serious Issues

Some serious matters regarding the Current Fiscal Issues in Pakistan, in light of the budget of 2015-16 are to be considered. Some of these issues are highlighted as under:

- ***Prioritization***

The total development expenditure of the provincial governments exceeds the federal PSDP in the Federal Budget 2015-16. Therefore, there is need to consider the issue of proper development priorities of the provincial governments which has become very important. The provincial government should not only focus on physical infrastructure (power and irrigation), but also in provision of basic services e.g., preventive health, safe drinking water and higher quality of primary education.

- ***Utilization***

Regarding utilization of the available service, products and resources, apart from their availability it is also a matter of utilizing the same in a best appropriate way in order to attain maximum utility. In many cases, facilities are provided to personnel of a department but either they are untrained or negligent and thus fail to avail the required standards.

- ***Leakages***

Leakages in tax revenue collection of the GST are not accurate, due to fake and flying invoice problem. The government fails to realize the larger revenue from the GST.

- ***Regional Disparities***

When talking about the regional disparities it may be stated that ‘not much was received through fiscal equalization’ e.g., Rural Balochistan vs. Urban Sindh; South vs. Punjab. In addition, only 5.11 per cent to 10.71 per cent was received by Balochistan.

In some of the areas there are parallel resources where the government and the private sectors are providing services to people, e.g., 40 per cent of children go to private primary schools whereas 85 per cent of the population of Pakistan goes to private doctors.

It is not a matter of focusing on more resources but also working on the existing resources or tapped new tax payers. In addition, there is more need to drastically improve the delivery of services to the major population of Pakistan.

9. Now the Big Emerging Issues

In addition to the above we also need to consider the big emerging issues, which are mentioned as under:

- ***Involvement of Provincial Governments in Power Sector***

After the 18th amendment the production of power/electricity is the responsibility of Provincial Governments, therefore, perhaps these governments may be able to meet industrial and household requirement for the population of their provinces.

- ***Water-Stress***

Water is another major stress and need to be focused for irrigation, especially crucial for Punjab, and other provinces. In addition, pure drinking water is also the need of the entire population of the country.