REPORT

Islamabad Policy Institute

Supporting Dialogue for Peace & Development

Pre-Budget Discussion

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Rapporteur

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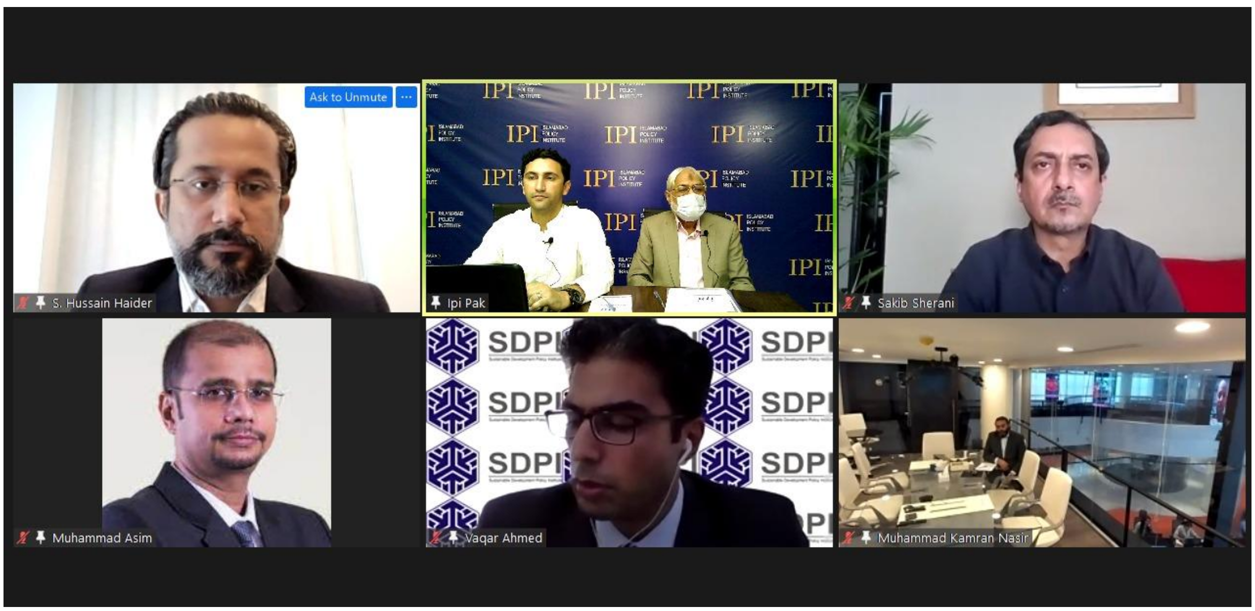
Islamabad Policy Institute Pakistan

Introduction

- As Pakistan Tehrik-i-Insaf (PTI) government prepared to present its third budget, Islambad Policy Institute organized a deep-dive session on the state of economic health of the country and issues that could have influenced the budget-making process.
- This year's budget was particularly important as PTI government was switching to growth from stablisation at a time when the country was in the middle of an International Monetary Fund (IMF)program.
- For past three years the general public has been reeling under heavy taxation while exports stagnated. The inflow of remittances, meanwhile, provided the government the much needed fiscal space for spending-orentied growth.
- This session focused on the challenges and oppurtunities for the government as it readied to present the budget that could support fiscal health and also back sustainable growth in the medium term and absorb external sector shocks.

The session was moderated by Syed Hussain Haider, who is a Capital Markets Analyst and a fellow with Islamabad Policy Institute.



Prof Sajjad Bokhari
Executive Director Islamabad Policy Institute (IPI)

- Islamabad Policy Institute is holding this discussion as part of its deliberations on public policy issues. These discussions aim at helping the public better understand the issues at hand, besides providing recommendations to the government to improve its policies.
- The government would be tabling the budget for the fiscal year 2021-22 in the next few days. The budget would be designed according to the political, economic, and social

objectives of the ruling party. However, the budget features would be heavily influenced by the amount of taxes that can be levied, the level of expenditure possible during the next year depending on the country's fiscal health, and debt obligations.

- The experts can shed light on some of these and other aspects that would possibly define the upcoming budget.
- The government has already publicly disclosed some of the features of the budget, the outlay of which is expected to be around Rs 8.4 trillion. The government reportedly intends to set Rs5.8 trillion as of the tax collection target for the next year, increase public sector spending by 38% taking it to around Rs 900 billion, and spend about Rs1.3 trillion on defense. It is, moreover, aiming to take the economic growth rate to 4.8%.
- As proof of the success of its economic policies over the past three years, the government spent weeks leading up to the budget celebrating the 3.8% growth rate achieved in the outgoing fiscal year despite the questions about the basis, quality, and sustainability of this growth.
- This politically driven exercise could have helped dominate the narrative on the airwaves, but it meant little for both the ordinary people and the business class that endured difficulties throughout the year.
- This skepticism about the government claims is also due to the absence of institutional reforms that could have ensured the sustainability of the growth, besides making it equitable. The government claims that economic recovery is based on a strong foundation – the 29% growth in remittances, 13.6% increase in merchandise exports, foreign investment in government debt securities, estimated 9.3% growth in large scale manufacturing, and 2.8% agricultural growth. Indeed, time is the best judge.
- All these figures look good on the face, but maintaining sustainable growth has been extremely challenging. For instance, the substantive decline in manpower export this year will in the next fiscal year affect the much-flaunted rise in remittances. Similarly, since the resumption of economic recovery, imports are growing at a greater rate than exports and this would ultimately lead to expansion of the trade deficit. Had it not been for a strong inflow of remittances, we would already have been in the current account deficit.
- The growth in foreign investment is mainly because of investment in government debt securities and the hot money by virtue of its nature can fly out at any time. LSM growth too is large because of the low base last year.
- Therefore, while I would not like to paint pessimism, I just meant to emphasize that it is time for making careful and prudent choices in this budget. The government should, therefore, instead of just managing the accounts focus more on developing strong institutional underpinnings of the economy.

First Session

Mr. Sakib Sherani
CEO Macro Economic Insights

- The growth rate achieved does not have a structural basis. Moreover, the figures of the growth that are being given are moot. The government is, in the meantime, working on structural issues and the results are to emerge gradually.
- Pakistan's problem is not just the tax to GDP ratio, a larger issue is the export to GDP ratio, which is about 8%. Countries in the region that developed had this ratio at around 20 -21%. This is one reason why we cannot sustain growth.
- The government is focusing on having export-led growth. This is a major change from the past. In the past imports were prioritized because of which neither the industry could develop nor the exports could be enhanced.
- Devaluation of the currency helped stimulate exports.
- Finance Minister Shaukat Tarin is working on the structural transformation of the agriculture sector. That's how you can grow the economy without dipping into the balance-of-payments (BoP) crisis.

Mr. Muhammad Asim
Chief Investment Officer at MCB-Arif Habib Savings

- Government's focus on increasing exports needs to be appreciated.
- There is a need to focus on the real estate sector and documentation of the economy.
- While the government struggles with SOEs, and the power sector, there is an urgent need for improvement in governance.

Dr. Vaqar Ahmed
Joint Executive Director, Sustainable Development Policy Institute

- The government's focus seems to be on kickstarting economic growth with the objective of job creation. However, it remains to be seen how sustainable would be these efforts because in the past similar attempts landed the country in a financial crunch or balance of payment crisis. Strategic direction is, nevertheless, right.
- There is a lot of hope on the tax front. A modern tax system is needed to fund human resources and infrastructure.
- Consideration is also being given to climate change and food security issues in economic discourse.

Muhammad Kamran Nasir
Chief Executive Officer, JS Global Capital Limited

- The focus of the governments in the past had been short-term. They borrowed, spent on infrastructure, could not get any output and there was no export conversion. This always led to a balance of payment crisis. This government appears to be moving towards export-led growth. It must facilitate industrialization and associated paraphernalia.
- Neglect and mistakes of the past have time and again led this country of 220 million population into the balance of payment crisis despite being such a large market and the existence of demand.
- The government is gradually and slowly learning from the mistakes of the past like its newfound focus on remittances. There are few things that the government should have done immediately after taking office but did them belatedly.
- While the federal government has been making progress, the provincial governments are lagging.

Second Session

Mr. Sakib Sherani
CEO Macro Insights

- This year's tax revenue generation of about Rs4.7 trillion is quite remarkable under the given circumstances. However, this revenue growth has not come from the widening of the tax base. This is our perennial issue.
- IMF program is very intensely focused especially after the setting of the indicative target for three months. FBR in this situation is left with no bandwidth to focus on other sectors that have been missed out. FBR, therefore, needs to reform itself and work on widening the tax base.
- It is important to know from where is this growth coming.
- Next year would be challenging for tax collection. There will be automatic growth due to tax elasticity resulting from GDP growth. This may take next year's tax collection to about Rs5.3 trillion, but meeting the IMF target of Rs5.9 trillion would be challenging. The gap would have to be filled through additional taxation measures.

Mr. Muhammad Asim
Chief Investment Officer at MCB-Arif Habib Savings & President of CFA Society Pakistan

- Documentation of the economy needs to be encouraged.

Dr. Vaqar Ahmed
Joint Executive Director, Sustainable Development Policy Institute

- Achieving the IMF target of above Rs 5.8 trillion in tax collection will be challenging. It may, however, not be a long shot if economic activity picks up especially given the targeted growth rate of 4.8%. Oil and commodity prices could also increase, which would make higher numbers manageable.
- Taxing without a long-term vision will hurt the long-term recovery and the post-pandemic recovery. Tax policy, administration, and culture need to be reformed.
- This year tax collection has come at the back of indirect taxes. We are still lagging in direct taxes.
- Indirect taxation has implications for the middle class and poor segments of society. They have long-term consequences for household debts and purchasing power.
- Pakistan has a fragmented tax system and tax harmonization is a long pending issue.
- Provincial tax departments have a large role to play. There are large tax bases that are provincial responsibility after the 18th amendment like services, transport, and agriculture sectors. The federal government has limited jurisdiction in these sectors.

Mr. Muhammad Kamran Nasir
Chief Executive Officer, JS Global Capital Limited

- The overall tax target is ambitious and widening the tax base is crucial for achieving it, especially if the existing taxpayers are not to be further burdened.
- Taking unpopular decisions in the latter part of the government’s tenure becomes difficult.
- Government expenses would have cut because the spending is slack. From the government’s spending tendency it looks like curtailing expenses is low on its priority. There are many departments where money is not well spent.
- Any tax target set by the government should not further burden the existing taxpayers.
- Taxes should be sustainable and should allow the businesses to expand through the rationalization of taxes and incentives.
- Government may find itself in a problem if it wouldn’t broaden the tax base.

Mr. Hussain Haider
Capital Markets Analyst/IPI Fellow & Session Moderator

- Finance Minister Tarin has claimed that there would be no new taxes, but that looks doubtful in the backdrop of the IMF program and statements by some of the other government officials.
- There are no out of box ideas with the government on expanding the tax base.

Third Session

Mr. Sakib Sherani
CEO Macro Economic Insights

- Around 85% of the net federal revenue is utilized for interest payments. It touched 103% in 2019. On the expenditure front, the government is facing enormous pressure - it is compelled to give a pay raise to government employees; large sums are spent on pension payments; and there is a dire need to invest heavily in the defence establishment, though there hasn't been any significant increase in defence expenditure for last three years.
- It is said that the government could not properly manage the public sector enterprises, which are a drain on the national resources. It is true and is related to structural reforms. Overall there is no room left for the government to over spend. Finance Minister Shaukat Tarin's strategy to increase PSDP is a big question mark for me. First, I am clueless about the sources from where the room for spending will be created, and secondly the benefits of going this route are uncertain. There is this traditional wisdom that without the PSDP growth, the economy cannot grow, I do not agree that it is the case.
- Efficiency of big spending is gradually declining for the last ten to fifteen years. It has undergone a marked decline since 2005. We have to spend twice or thrice on the public sector than what we used to do in 2005 to show the same level of output.
- Efficiency in current spending should be improved to move towards growth rather than an increase in overall spending that cannot even support the balance of payments.

Mr. Muhammad Asim
Chief Investment Officer at MCB-Arif Habib Savings & President of CFA Society Pakistan

- It is usually believed that government accounting is cash accounting. When the circular debt is approved, it is not incorporated into expenditures and budgets. When circular debt is not addressed and approved directly, it makes an understatement.
  Gas circular debt is less discussed than the power sector because it rarely comes under the limelight like the power sector. Gas circular debt is a problem, and it is the area our government can look at and incorporate into the expenditure.
- PSDP's link with GDP growth should be established. Even if not the entire PSDP, then a portion of it.
- Pension bills are a major burden when we have such a large chunk of youth to cater to.
- The government needs to focus on the inflation number because domestic factors are closely linked with these numbers.

Dr. Vaqar Ahmed
Joint Executive Director, Sustainable Development Policy Institute

- Fiscal space is declining over the years and debt servicing is going up. It is becoming increasingly hard for the federal government to service this debt with limited resources. It would be difficult in the medium term to rationalize expenditures in a big way.
- A strategy should be put in place to gradually realign our focus on growth and job creation priorities.
- Reprofling of debt should remain a priority agenda. Regarding the government, public sector, law and order, and defence, I see the expenditure going up as their needs will increase over time. Within this public administration expenditure, I see some room in the area of pension through innovative solutions for those who will be retiring soon. If not taken care of on war footing, the budget issue will become unsustainable by 2024. We will be then procuring debts to pay pensions.
- On the development budget side, there exists a concern about financing of PSDP and ADP projects.
- We should put a break on new projects and instead work on existing projects that were started after deep appraisal. The efficiency of public spending is a concern as it hampers economic recovery. None of the provincial governments could fully utilize the Covid-19 fund and even the federal government diverted some of the money to other projects. We need investment in agricultural productivity, expansion of export value, and betterment of the youth. These priorities can improve national productivity.
- There is a need to study provincial budget priorities. Punjab’s development program is eight times bigger than that of the federal government. Moreover, SDGs are provincial responsibility, which further underscores the need to study provincial budgets.

Muhammad Kamran Nasir
Chief Executive Officer, JS Global Capital Limited

- The government should reform the retirement policy.
- Critical projects should be completed as an overriding priority instead of letting them fall victim to political witch-hunt. When projects are halted halfway, their restart has huge economic cost.
- The government should prioritize public sector instead of putting it on the backburner.

Final Session

Mr. Sakib Sherani
CEO Macro Economic Insights

- An attempt to achieve growth through increase in PSDP spending will increase fiscal deficit.
- In the fiscal year 2021, the increase in public debt is, in real terms, negative. This points to the responsible fiscal function of the current governmet. There is a need to carry forward this narrative to control the debt which stands out at 81% of GDP.
- As long as revenues are not generated, we should tightly control expenditures. It will pose a great challenge for the finance minister if he wants to expand the PSDP.

Mr. Muhammad Asim
Chief Investment Officer at MCB-Arif Habib Savings & President of CFA Society Pakistan

- If we want to avoid a debt trap, we must make sure that our debt servicing cost or growth in overall debt remains lower than nominal GDP growth.
- We should keep our growth higher in nominal terms ,and, in real terms, GDP growth should stay higher.
- Our net incurrence of debt levels will continue to grow. We need to keep a watch on it as well. The angle of inflation will emerge. Then our GDP growth as compared to the nominal growth will be less. Inflation will have severe implications for GDP growth and debt servicing.

Dr. Vaqar Ahmed
Joint Executive Director, Sustainable Development Policy Institute

- Debt management is like a ticking bomb especially after the Covid-19 crisis. A more promising debt strategy is needed than the cosmetic pledges uploaded on the official website of debt office of the Finance Division.
- This year the expected fiscal deficit to GDP ratio was around 8.4%. It is feared that public debt to GDP could go up to 94% and as we witnessed in 2019, just a bit of volatility of the rupee can take it beyond hundred percent. We must be mindful that it is not just about the existing debt but the fact that any future wave of the Covid-19 can leave us with more debt at hand.
- When we look at external debt, getting more loans is a strategic question. The traditional external sources have been shrinking. We have just seen how longstanding partners pulled back large chunks of their funds not because of any change in political relations with Pakistan, but due to emergencies they had been facing at home. We should no more be looking at traditional partners for loans because debt and aid obligations are shrinking globally.
- One must now look for reprofiling of debts. I think it is where the Chinese are becoming increasingly dear to us.
- On the domestic front, the federal government must strive to give more confidence to local players, so that they are brought into the debt market.

- In the last 12 to 14 months Pakistani diaspora have activated, who are helping in a big way in meeting expenditures and initiating development through participation in initiatives like Roshan Digital Account and Naya Pakistan.
- Our institutional investors neither have long-term confidence nor see benefits of investing in Pakistan, let alone expecting investors to come and invest in Pakistan. There should be more appealing investment instruments for locals.
- A large part of the economy is still untapped. In innovative financing, regulators should help the government go beyond existing efforts like climate financing, food security, and investing in green bonds in the country.
- Social enterprises are waiting to be funded in the country, which can take away a lot of burden from the government. Many of the targets the current government is willing to pursue through debts can be pursued through this.
- There is looming risk of sky-rocketing debt levels once the intensity of the pandemic of Covid-19 withers away.

Muhammad Kamran Nasir
Chief Executive Officer, JS Global Capital Limited

- Debt must be contained within sustainable level. We need to expand our exports.
- There is a large chunk, more than 60%, of the untapped population in Pakistan. They should be streamlined into financial systems, so that all investments go to the national treasury.