Institute for Policy Reforms

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Time for Government to Revive the Economy

The Institute for Policy Reforms has urged government to switch from a policy of stabilization to revival of the economy in order to ease difficulties faced by the people. This was stated in IPR's Budget Strategy Paper for 2015-16 released at an event held today at Islamabad. Dr. Hafiz Pasha, Managing Director IPR, and former Finance Minister gave the presentation.

Mr. Humayun Akhtar Khan, Chairman IPR and chair for the session, stated that weak economic performance of recent years had increased the burden onthe people. It is important to look at the economy's growth potential rather than focus on the limited criteria of reduced fiscal deficit and increase in forex reserves.High cost external borrowings have increased foreign reserves. It is moot if such levels of indebtedness are sustainable for the economy. Before long, debt servicing will begin, which will add significantly to government expenditure and to fiscal deficit. Fiscal deficit would increase also if government settles outstandingcircular debt, which has accumulated to over 500 billion rupees.There is weak performance all around. Government has been unable to improve tax collection. Exports and large-scale manufacturing have been sluggish in the face of an overvalued rupee and continued load shedding. Government's total focus seems to be with meetingfiscal standards set by IMF with scant regard for citizen welfare.

Dr. Pasha stated that government's focus on stabilization under the IMF program comes at the costof growth of the economy. Unemployment and poverty have both increased in the last six years. IPR takes issue also with the quality of stabilization and the measures taken to achieve it. Reduction in development expenditure, increase in indirect taxes, high cost external debt, and increasing circular debt have depressed growth and added to the difficulties of the people. It is time for government to take measures to revive the economy.

GDP growth for fiscal 2014-15 will fall well short of government's target rate of 5.1%.The actual rate would likely be close to 4%. Growth in large-scale manufacturing has been a paltry 2% for the period July to February 2014-15.

The Budget Strategy Paper strongly advocates exit from the 'low growth trap'in which the country finds itself. Government must adopt a 'radically different' approach of switching from the stabilization mode to revival of the economy in the coming fiscal year. It must set its eyes on at least 5.5% GDP growth rate for fiscal 2015-16. IPR proposes a change in policy as well as suggests specific steps to reach the target. With a certificate of good health from the IMF, following the build up to foreign exchange reserves to almost $13 billion and the fall in rate of inflation to below 5 %, thegovernment is in a position to adopt a policy of revival. .

A combination of policies will increase growth. These include fiscal stimuli, tax reforms, an expansionary monetary policy, and a competitive trade policy. Dr. Pasha recommended that the coming fiscal year 'ought to have a tax free budget'. Current tax rates must not be enhanced and no new taxes should be imposed. Government must send a positive signal to the private sector by reducing thecorporate tax rate from 33 to 30%.

Increase of Rs. 500 billion is recommended in the combined development expenditure of the federal and provincial governments which would also stimulate growth. At the Federal level this is necessary to draw in financing from China for infrastructure projects in the CPEC Also,in the short-run, public investment increases GDP by a multiple of two and 'crowds in' private investment because of better infrastructure.

Government must find ways to reduce non-development expenditure and increase tax collection. One way to control expenses is to reduce subsidy on electric power. Higher gas allocation for power will reduce overall cost of power and along with it the amount of subsidy. To increase tax revenue, FBR must broaden tax base focusing not only on individuals, but also on companies. There are leakages also in collection of the GST. Government fails to realize larger revenues from it because of thefake and flying invoice problem.Also, in order to show growth in revenue, refunds to the private sector are held up. There is need to study the case for switching to a single stage sales tax regime, preferably at the point of final consumption.. In addition, government must continue with this year's policy to withdraw SROs on import duty and GST. Because of suspected under invoicing of imports, there is a strong case to introduce minimum import prices.

In view of low inflation, IPR recommends that SBP may bring down policy rate to 7% and allow concessionary credit at 5% for exports. Government must limit borrowing from commercial banks to 2.5% of GDP and enable more diversion of credit to the private sector. With respect to trade policy, Pakistan has not made full use of the GSP plus scheme. This is because of an overvalued rupee exchange rate. In recent months, exporting countries have been competing to reduce the value of their currency in a tight global market.On the other hand, Pakistani exporters have suffered because of the high value of therupee. This has resulted also in increase in imports. IPR recommends a reduction by 10% in the value of the rupee.