INSTITUTE FOR POLICY REFORMS

IPR FACT SHEET

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Review of Budget 2016-17

About IPR

Institute for Policy Reforms is an independent and non-partisan think tank established under Section 42 of the Companies Ordinance. IPR places premium on practical solutions. Its mission is to work for stability and prosperity of Pakistan and for global peace and security. IPR operations are supported by guarantees from the corporate sector.

Introduction

Despite high claims, budget 2016-17 does little to address the real issues of the economy or to revive growth. IPR does not find a strong economic strategy driving budget 2016-17. There is need to build productivity of agriculture and industry to revive the economy and place it on a path of sustained growth. While government has announced a series of measures for these sectors, IPR prefers an approach that does not rely on fiscal incentives alone. These sectors need long term commitment to build competitiveness.

The Pakistan economy faces many challenges. Its growth has been moribund for several years. Agriculture production has declined. Exports are in a precipitous long-term fall. Power and energy remain short. The external sector is vulnerable, as government borrows new loans to pay off old ones. The performance of industry is mixed. Textile production is stagnant and some other key industries languish. Services, not the productive sectors, have fueled the economy's growth of 4.7%. The situation demanded a strong and well-considered policy response.

It is curious that the basis of government's mid-term and annual plans rely on population estimates extrapolated from the 1998 census. It makes suspect all planning and budgets.

Budgetary Outcomes:

GoP deserves credit for keeping fiscal deficit in control during fiscal 2015-16. The government may likely meet the fiscal deficit target of 4.3%. Increase in tax collection and control on expenditure

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have helped keep the deficit in check. For the first time in many years, FBR met the tax revenue of Rs. 3,104 Billion, set in the beginning of the year. Remarkably, direct taxes grew by 13%, though the share of indirect taxes increased further. FBR made important efforts to broaden the tax base. These include serving notices on non-filers and increase in withholding tax rates for them. 'Other taxes' too increased significantly by 35%. In a year of low energy prices and falling markup rates, non-tax revenue fell by 25%. Expenditure grew by a mere 6.4%. However, development spending was well below budget. This has helped GoP to control deficit.

Budget 2016-17 Framework:

For fiscal 2016-17 too, government has maintained a preference for stability. The budget aims for a fiscal deficit of 3.8% of GDP and a growth rate of 5.7%. While GoP's focus on continued stability is welcome, the deficit of 3.8% is too low for the economy's needs for infrastructure and other services. To its credit, FBR achieved the target of almost 20% increase in revenue in the current year. However, it will need to increase collection by a further 16.6% in 2016-17. This will mean a real rate of increase of 6% or more, if we take away inflation and growth expectations. Shortage in revenue will invoke cuts in development expenditure. This will affect much needed improvement to infrastructure. It may also affect execution of CPEC projects.

Limiting increase in current expenditure in 2016-17 to 3.6% over 2015-16 will be a challenge. In the ongoing fiscal year, current expenditure was set to reduce from the previous year, along with reduction in debt servicing. In effect, they grew by 6.4% and 19.5% respectively. Next year too debt-servicing expenditure will increase. Along with increase in allowances of government servants and in pensions, this will stress the fiscal framework and make it that much more difficult to achieve the deficit target.

The 2016-17 budget reduces provision for subsidies by 29% from the revised estimate of 2015-16. Over two thirds of this amount is for the power sector. As fuel price is on a slight increase, it seems that government plans tariff increase or further postponement of payment of the tariff differential subsidy.

The budget estimates provincial surplus of Rs. 339 Billion. The fiscal deficit will go beyond the target of 3.8% of GDP if provinces do not yield the surplus amount.

In a positive move, the Finance Minister announced GoP's plan to observe provisions of the fiscal responsibility law and to strengthen its provisions.

Tax proposals

The target of a further Rs. 517 Billion in FBR taxes will stretch the collection system. Over 45% of the additional tax revenue is to come from income tax, mostly in the shape of withholding tax.

Enhancing holding periods for capital gains on securities and real estate is a positive move. Until recently, such unearned income and gains were exempt from tax. It restores a sense of equity and reduces excessive speculations.

Recently, some members of the Tax Reforms Commission have expressed dismay for not relying on their recommendations. Most of these aim to strengthen tax administration and enforcement. They feel that adopting the recommendations could help reduce tax evasion. In IPR's view, it is important to raise the cost of tax evasion and, especially, non-filing of returns. As a run up to the budget, some GoP officials seemed to favour this approach in their public statements.

Fifty-five percent of the extra tax collection in 2016-17 comes in the shape of indirect taxes. These are desirable to the extent they withdraw exemptions. However, they could affect economic activity. IPR supports use of withholding tax as a means to attract non-filers. However, the best course is for this tax to be collected through annual assessments.

IPR welcomes the proposal for zero rating of five major export products. This will ease a major issue faced by exporters.

Incentives for revival of agriculture and industry

The budget contains a number of incentives for the productive sectors. GoP's efforts to revive agriculture centre on reduction in input cost and other fiscal incentives. Revival of industry is based on fiscal incentives, facility for subsidized credit for export (LTTF), and setting up a technology up-gradation fund. Some past incentives that are to lapse have been extended. While these are positive steps, some observations are necessary. There is no word about evaluation of whether or not such incentives stimulated growth in the past. This was important to ensure that the incentives work and have the desired effect. These sectors need long term support with technology diffusion and access to capital. Fiscal incentives work for the duration they are available. They do not always promote efficiency or competitiveness and at times create dependency. Government has not looked at these sectors holistically.

While reduction in input cost will help, agriculture suffers from neglect of water resources and management. The proposals also do not address the real issue of improving seeds and restricting virus. GoP cites volatile prices as the reason for decline in production. However, most agriculture indices show a downward trend. This year's PSDP provides Rs. 31.7 Billion for the water sector. This is Rs. 15 Billion less than the allocation of 2014-15. Water must receive higher priority.

Our exports will grow mainly through revival of industry and agriculture. This is critical for an economy effectively in a debt trap. In GoP's view, the export problem is one of falling international prices. A greater concern is that our export to GDP ratio is in serial decline. This ratio is 5.5% this year against 6.6% last year. It was 10.3 % in fiscal 2013-14 and remained above 10% throughout the 2000-2010 decade.

Regardless, we hope that these incentives will have the desired effect on growth.

Impact of the Budget on Growth and Living Standards

As stated before, the budget makes no big moves or set a strategic direction. Immediately, it will have no significant effect on the people. The budget has minimal relief for the people. It is good to see continued commitment and enhancement of the Benazir Income Support Programme. The increase in minimum wages of Rs. 1,000 is small and affects a limited group of people. Decrease in subsidy or increase in power tariff, if they take place, will affect people in the lower quintiles. Increase in GST, FED, and import tariff on a large number of consumer and industrial items will increase prices and burden on the poor. It will also increase inequality.

The development budget directs few resources towards reducing the social deficit. Admittedly, this is a subject for the provincial and local governments to address. However, the federal government does not state it as a priority. There was no mention of SDGs as a national narrative. Improving provision of basic human needs adds to the total capacity of the economy and stimulates growth.

Some of the incentives to revive agriculture and industry should have a positive effect. Reduction in cost of agriculture inputs will help farmers. It is to be seen how the rest of the incentives benefit growth.

Development Budget- the Federal PSDP

As in past years, the federal PSDP of Rs. 800 Billion is short for the many needs of the economy. It is about 2.5% of the country's GDP of Rs. 31,466 Billion. Including provincial budgets, Pakistan's total public investment will barely exceed 5% of GDP. The federal PSDP is merely 18% of the total federal budget of Rs. 4,418 Billion. Low allocation for development is reason for concern. The Pakistan economy has been in low to modest growth for several years. The people of Pakistan expect jobs and economic activity to grow. Serious infrastructure gaps and social deficit constrain business development and depress living standards. They are important for providing stimulus to the economy as well as to enhance business competitiveness.

In essence, the effective federal PSDP is Rs. 655 Billion and not Rs. 800 Billion. It includes allocation to a number of items that in fact belong to the current budget. Provision of Rs. 100 Billion for resettlement of IDPs is for an important cause, but is not investment. Similarly, provision of Rs. 20 Billion for the PM's Youth Programme is current budget shown as investment. The PSDP document does not show projects against these provisions indicating that they may not have gone through the rigorous process, which evaluates efficacy of expenditure and evaluates past efforts.

To reiterate a problem that has existed for long, the PSDP minimally meets the needs of an oversized projects portfolio. The modest scale of the PSDP contrasts with the enormous size of the federal government's public investment programme. Projects in the federal PSDP number 992. Of these, 179 are financed off budget by WAPDA, PEPCO and NTDC, leaving some 813 projects.

In all, PSDP projects have a throw forward of over Rs. 3 Trillion. On an average, these projects would take about eight years to complete, if there were no cost increase from delays. Most water- sector projects will take eight to twelve years to complete at present costs. Because of renewed focus on roads, NHA's throw forward alone is Rs.1.4 Trillion.

Compared to the revised PSDP of Rs. 700 Billion for 2015-16, next year's budget shows an increase of 14%. Since 2015-16, cuts have been placed in some critical areas. The combined allocations for higher education and federal education and training are a Billion more than last year, but Rs.5.4 Billion below 2014-15. The allocation for HEC mostly meets stipends for students studying abroad. Many HEC projects which has a total throw forward of Rs. 142 Billion would stall. Allocation for health has increased by Rs. 4 Billion, but it is still Rs. 3 Billion less than 2014-15. As noted above, water is a big cause for concern. As a water stressed country and with high dependence on agriculture, this is alarming.

Of the Rs. 130 Billion for the power sector shown in the PSDP, GoP's budget is Rs. 74 Billion. The rest is to be met by WAPDA, PEPCO, and NTDC. Of the Rs. 74 Billion, Rs. 60 Billion are for the two LNG power projects. IPR would have preferred to see such large amounts go to hydro projects and not to an expensive fuel source. In fact, other than LNG power plants, federal allocation for the power sector has declined substantially compared to 2014-15. This is astonishing when the country faces extreme power shortage. On the other hand, allocations to roads and highways have increased by 17.5%. Allocation for NHA had increased by a large 46% in 2015-16.

IPR finds that the budget 2016-17 has no strategy or imaginative ideas to address the many issues facing the country. It is a business as usual budget.