INSTITUTE FOR POLICY REFORMS

IPR REPORT

June 2021

Budget 2022: Balancing stability and growth

About IPR

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This report is a summary of an online discussion held by IPR on 30 May 2021. The speakers were:

- *Mr. Shaukat Fayaz Ahmad Tarin, Minister for Finance and Revenue*
- *Mr. Humayun Akhtar Khan, CEO and Chair IPR*

Moderator: Ashraf M. Hayat Executive Director

View the webinar: https://www.youtube.com/watch?v=ZSg234TM6Lc

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Setting the stage: Humayun Akhtar Khan

- Pakistan's economy over the last 20 years has consistently been close to default, with the current account mostly in deficit. Only in three years of the past twenty, has the current account not been in deficit.
- An overvalued Rupee encouraged cheap imports (i.e., oil and food) and affords fleeting veneer of economic wellness. In these periods of apparent prosperity however, exports suffer as they become more expensive.
- Pakistan's external debt has continued to grow. Over the last 20 years, our debt has grown three times, even though we have repaid (principal and interest) more than we have borrowed. Continuous rollover of debt has put pressure on our fiscal and current account. Debt servicing is our largest expenditure. It has grown at a pace that leaves little space for government to offer other services. Currently, external debt servicing is almost twice the size of our public sector development program, both federal and provinces combined.
- Savings in the economy are too low to sustain growth, and its rate is declining. We still depend heavily on worker's remittances, although this money seldom goes into investment.
- Credit available to the private sector has declined over the last 20 years. All former Pakistani DFIs are now defunct, crippling project financing and investment. There is a direct relationship between high performing DFIs and industrial growth.
- New jobs must come from the private sector. Government's share in employment is less than 20%.

- PSDP investment is whimsical, subject to the interest of the administration of the day. It is also typically the first head of account to be cut in times of need, which is mostly all the time. This shows the level of its priority.
- Labor productivity is low. There exists little to no product innovation, value addition, or employment of technology. As a result, our products face poor outcomes in the international market. It is because of lack of investment in human capital.
- Pakistan has not experienced sustained growth since the 60's. Any growth spurts since then have been dependent on the flow of financial aid from abroad, and too short-lived to deliver effective change.
- Alarmingly, both agriculture and manufacturing are shrinking as a percentage of GDP, from lack of investment and for want of policy reforms. GDP growth relies on consumption and service sectors. The service sector is mostly inefficient and lacks competitiveness.
- We must follow the East Asian model of capital accumulation and structural transformation to build and upgrade manufacturing. This is the only way to compete in the global market.
- Human resource development must be a priority.
- Regional disparity in resource allocation must be addressed. 85% of tax revenue is spent in nine cities.
- As China looks to outsource employment in what it considers to be sunset industries, we must encourage them to choose Pakistan. For us, these industries such as textile, appliances and leather goods are still essential.
- Exports are key to Pakistan escaping its cyclical economic crises. Each time our economy goes into decline, it is because of the balance of payments and shortage of foreign reserves.
- An Economic Advisory Council has been assembled to advise the government on policy in 12 sectors.

Budget 2022, balancing stability and growth: Shaukat Fayaz Ahmad Tareen

- Although during the last government's tenure we experienced a growth rate of 5.5-5.8%, we also experienced a massive current account deficit of almost $20 billion. An overvalued Rupee caused a decline in exports, which fell from $25 billion in 2013 to $21 billion in 2018. The economy also suffered from a high fiscal deficit.
- Pakistan was once again faced with near default and a ballooning circular debt. Capacity payments grew to about 465 Billion Rupees a year.
- In the 2008 IMF programme, Pakistan's key role in the war on terror prompted the IMF to offer a very attractive deal.
- The most recent IMF programme offers much harsher conditions. Interest rate was raised to 13.25% even as core inflation at the time was 7%. These decisions cost Pakistan hundreds of billions of rupees. Additionally, the forced drastic devaluation of the rupee triggered a sharp increase in gas/electricity costs and tariffs, serving to further the cycle of circular debt. The economic growth rate was 1.5-1.9% until pre-COVID, when it went into the red.
- The Prime Minister's construction package has come as a boon. It potentially created mass employment and through linkage, is supporting over forty industries. The economy started to stabilize, and CAD is now in surplus.
- This stabilization has led to recovery. All major sectors are in revival: large-scale manufacturing, exports, services, housing and agriculture (cotton being the exception).
- This stimulus has invoked signs of economic revival. Government revenues are set to cross 4 Trillion Rupees for the first time in Pakistan's history.
- A newly formed Economic Advisory Council has been tasked to finding an exit from our circular debt trap. EAC is also working on recommendations to boost twelve key sectors (including agriculture, manufacturing, power, financial, and housing sectors) and offer short, medium, and long-term plans for each of them.

- We hope that these comprehensive economic plans would assist current and subsequent governments to support key economic sectors. This is how all nations who experienced significant economic growth have progressed.
- The strategy for growing our economy must begin with increasing revenues, which currently make up less than 10% of GDP.
- We must also increase public sector development spending. This year PSDP will receive 650 Billion Rupees. Next fiscal it will reach 900 Billion Rupees. Instrumental to this effort are public-private partnerships, which will leverage PSDP funds into higher investments.
- From a wheat exporting country, Pakistan has unfortunately become wheat importing country. The new budget will work to address this by offering an array of incentives to the agriculture sector.
- By promoting e-commerce, we can drive our growth from a pure cash economy into a digital economy, a transition that will open up new avenues for revenue collection.
- The power sector demands immediate attention. A whopping 2.3 Trillion Rupees of circular debt must be paid. It is important to find a solution to this continuous drain on taxpayers' resources. Capacity payments are set to increase to 1.45 Trillion Rupees annually. This astonishing amount is three times of what it was in 2018, 465 Billion Rupees. Unless financially viable, the power sector will fail to attract investment.
- The Prime Minister has vowed not to increase energy tariff in the near future as energy costs have been unsustainably high.
- Middlemen in the agricultural sector unabatedly claim margins of 400-500%. To improve efficiency and produce a surplus, the agriculture sector will require storage systems and a mechanism to allow farmers to access wholesale markets directly. We may also consider the reinstatement of price control magistrates.
- We will not depend only on the trickle-down effect to boost incomes of working people. Instead, we should employ a bottoms up approach, as US president Joe Biden too has declared necessary to curtail the United States' wealth inequality. The 4 to 6 million

households amongst the lowest economic strata in Pakistan must receive a fiscally viable package offering access to healthcare, housing, and employment.

- The new budget will feature announcement of universal self-assessment and third-party audit for 3-4% of risk-based population. This should free citizens from alleged FBR harassment.
- Tax evaders will be pursued and prosecuted with the help of technology.
- Of the 80,000 POSs (points of sale machines), only 10,000 are linked to the FBR. GoP plans to take this number to 500,000 POSs by encouraging digitalization of the economy. Following a successful global model of substantial rewards, we hope to receive information about transactions to catch tax evaders. More digitalization will also incentivize the market to increase legitimate transactions. It will ensure that collected GST, that presently comprises 5% of tax revenue, is deposited with government.
- In association with the Ministry of Commerce, GoP will work to build productivity of export industries. This transition represents a paradigm shift as we move away from FBR's control towards a friendlier approach to taxpayers.
- Exports will be incentivized through SEZs. 1.5% of turnover tax will not be applicable to SEZs.
- Value-added exports will be incentivized.
- IT incentives will be enhanced. IT exports this year were about $2 Billion, a number which should grow to 8 Billion Dollars by 2023.
- The introduction of more payment gateways will usher in a new age of e-commerce and revenue streams. With the entry of Amazon and other international players into Pakistan, we should make our best effort to facilitate and streamline growth in this sector.
- We must promote FDI for the export sector and differentiate between export and import substitution. Exports are a priority. China, Malaysia, India, Turkey all employed FDI to boost exports.
- Our family-centered business models cost us export markets, as families inevitably fracture their businesses. The CRA (Corporate Restructuring Act) will work to address this.

- Our education level at 60% is insufficient and our poor health metrics reflect the subpar outcomes of our population. PM Imran Khan intends to quadruple education and health expenditures.
- The financial sector requires our attention. Our banking footprint is only 33-34% of the GDP which compares poorly with other Asian economies.
- Our entire formal economy lacks access to capital markets and thus relies entirely on banks for project finance. The banking sector however only supports them 16-17% because the advances-to-deposit ratio is only 50%.
- We must create capacity to fund private projects and infrastructure with the reinstatement of domestic DFIs.