SDPI

Sustainable Development Policy Institute

25 Years 1992-2017

Bridging Research Policy Gaps

A Review of Federal Budget

2017-18

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Part 1

Revitalizing economy by balancing defense and development

By Dr Abid Qayium Suleri

Prime Minister Nawaz Sharif made a record by becoming the first democratically-elected premier who has presented the fifth consecutive budget in a single tenure in the 70-year history of Pakistan. Although Pakistan People's Party government also completed its five-year term, they had two prime ministers in that tenure.

There were a lot of expectations from amongst the people as well as pressure within the party in the run-up to the election that the federal budget 2017-18 would be an election-friendly budget. After all this were to be the first independent budget presented by the PML-N government. The initial four budgets were prepared under the International Monetary Fund (IMF) program. Therefore, in those four budgets, the conditions imposed by the IMF framework took priority in the budget-making process.

The PML-N government had to use its newly-found financial autonomy (after the successful completion of IMF program) in a situation where the economy is stable compared to 2013, but still far from being sustainable. Contributing to the lack of sustainability in the economy are: a) Trade imbalance hitting a historical low, b) Sharply falling remittances, c) Fiscal deficit (which for the first four years was slightly under control compared to 2013 but is again sliding up), d) Current account deficit (the budgeted target for 2016-17 got missed and is already doubled), and e) Prices of petroleum product in the international market, which are on the rise. The finance minister is wary of the situation.

In this context, a government that is in doubt regarding re-election will give a popular or election-oriented budget and go on a spending spree. If the popular budget gets them the votes, it will be a win-win situation, but if it does not, the successor government will be facing the brunt. Looking at the current political scenario, the PML-N seems confident that it will be able to retain the current status quo, if not better. Although they could not make governments in Sindh and Khyber Pakhtunkhwa (KPK), they are still confident that they will be able to come back in the center. This is the prime reason that the budget is not as election friendly as was expected. Rather, it is a business as usual and is prepared following the template used by the earlier governments.

In this template, fiscal deficit is taken as an entry point. Successive governments have been trying to meet this deficit by inflating the revenues and deflating the expenditures. They rely on indirect taxes as a major source of revenue. Increasingly, major expenditures can be categorized into 4Ds:

1. Debt Servicing
2. Defence
3. Day-to-day Administration
4. Development

Likewise, this time too, the net federal revenue would be barely sufficient to meet the first two "Ds" and the rest of the expenditures would be met through borrowing and external assistance.

This time the net federal revenue is budgeted as Rs2926 billion. The debt servicing is budgeted to be Rs1363 billion, and defence will be Rs920 billion. The remaining amount, i.e. Rs643 billion is what the federal government is left with to take care of the third and the fourth D. The third D includes the running of the civil government, whole federal administration, pensions, subsidies, grants, direct allocation, etc. Whereas the fourth D is PSDP, which amounts to Rs1 trillion.

As it is presented in the budget, the difference between revenue and expenditure is almost Rs1900 billion (Rs1826.8 billion to be precise). To remain within the budgeted fiscal deficit of 4.1% of GDP, the deficit should not exceed Rs1479.6 billion. Thus, a provision is made for the provincial surplus to the tune of Rs347.3 billion. The 4.1% of GDP fiscal deficit would be met through external loans and domestic financing.

Since the government is confident to win next general elections and knows that it would have to deal with any financial mess that it creates now, so it sticks to a prudent approach. However, my concern is that the fiscal deficit will cross the budgeted target. The budgeted power sector subsidies (to WAPDA/PEPCO/KESC) amount to Rs117 billion. There is no provision for circular debt, which stands at Rs414 billion as of today. Moreover, there is neither a provision for fertilizer subsidy, nor for the refunds of exporters from FBR. In the best case scenario, these unaccounted expenditures would add up to another 2 percentage points of the GDP (Around Rs600 billion) to the fiscal deficit.

On top of it, despite the finance minister's prudent approach of the finance minister, the prime minister and his colleagues would announce development schemes and electoral packages, which will add further burden to the economy. So, we expect the fiscal deficit to touch around 6.5% of GDP by the end of 2018 if the petroleum prices remain the same. Any further slip on fiscal deficit, and going back to IMF in FY2018-19 would become unavoidable. Investment coming from China-Pakistan Economic Corridor (CPEC) may ease up the situation a bit.

Despite the above-mentioned constraints, there are some positive points in the budget too. Among those, budgetary measures on agriculture are worth mentioning here. Having ignored agriculture in the initial three years, the government has realized its importance, not only for GDP but also for the next elections. PML-N is hoping to spend on agriculture and get votes from rural areas of the Punjab thus compensating for PTI's growing influence in the urban centers.

In case of fertilizer, popular demand is that the General Sales Tax (GST) on fertilizer, especially Urea may be lowered. The GST is imposed once on the supply of gas to the fertilizer plant and also applied on the retail price of Urea. The government has decided to withdraw the GST on gas supplied as raw material to the Urea plants. Moreover, the price of imported urea lying with National Fertilizer Marketing Company has been fixed as Rs1,000 against the current market price of Rs1,400 per bag. Reduction of markup for agri-loans (though for owners of less than 12.5 acres and for a loan upto Rs50,000), and duty free import of combined harvesters are other welcoming steps.

Another commendable effort by the government in this budget is the Federal PSDP. Even though the PSDP is borrowed and dependent on external sources, it has been increased by almost 300% from Rs320 billion in 2013 (PPP's last budget) to Rs1 trillion. The releases against the PSDP funds in this government have been efficient. In FY 2015-16, almost 90% of the allocation was released and the same is expected in the current year as well. The total amount of Rs1 trillion kept for PSDP is mainly (around 70%) infrastructure and 30% for the soft development projects. One more worth mentioning aspect of PSDP is the amount allocated for Higher Education Commission (HEC). The allocation has been increased from Rs21 billion to Rs35.5 billion, which is a marked increase from the past allocations.

Social sector, including education, health, drinking water, sanitation, environment, sewerage, etc. now falls under the provincial mandate. Besides some direct grants, a huge amount of Rs1112 billion has been allocated for provincial PSDP. With such high allocations, the provinces ought to take care of most of the social sector needs in their jurisdiction. If that is not happening, then one needs to carry out a realistic assessment of the 18th amendment, especially whether the social sector should be provincial subject, federal subject or taken care jointly by both the federal and provincial governments.

While the federal government is trying to make both ends meet through juggling between first two (debt, defense) and last two (day-to-day administration, development) "Ds", one must ensure that provinces contribute towards a stable and sustainable national economy. The provincial governments should release their economic surveys vis-à-vis the economic survey of Pakistan. In addition, the provinces should also show their GDP growth and major contributors of that growth.

While it was historic that the current government presented its fifth consecutive budget, the mere fact that others could not achieve this milestone reflects the vulnerability of democratically-elected governments. The non-democratic forces toppled the elected governments on the pretext of the latter's inability to deliver on social sector development. As has entered in its fifth year, the government must understand that GDP growth sans job creation and livelihood security means nothing for ordinary citizens. PML-N government needs to focus on the improvement of human security by spending more on education, health, and livelihoods. This action would not only provide relief to general masses but also ensure the continuity of democratic set-ups in the future.

Budget 2017-18: A sustainability perspective

By Dr Sajid Amin Javed

Federal budget 2017-18 is positive in the sense that allocation for PSDP and agriculture are worth admiring and cannot be ignored. PSDP has been increased to Rs 1001 billion from Rs 700 billion in the last fiscal year. Similarly, increase from Rs 21 billion to Rs 35.5 billion for higher education is also commendable. Last but not least, one must appreciate the government for staying focused on stability of economy and not presenting an overwhelmingly election budget. It is rare to find such an example. Over all, in the broader politico-economic perspective, this budget can be assessed under three basic criteria.

First, to what extent the budget is heading the economy towards its long run objective of sustained economic growth and development.

In this regard, ad hoc solutions make most of the budget proposals and no significant reforms are announced to control falling exports, reduce dependence on indirect taxes, increase tax base, attract foreign investment, boost national savings, and improve labour productivity. The proposed budget seems to be a continuation of "consumption based economy" led by "indigenous growth" model.

The priorities of health and education take the back seat once more with the allocation of Rs 59 billion (of which Rs 10 billion for hospitals) for health, and Rs 35 billion for higher education. Overall budget 2017-18 allocated Rs 132.521 billion for education of which current budget equals Rs 90, 516 suggesting development budget of Rs 42.005 billion. Most importantly, the allocation for education, though witnessing a growth of 21.6 %, fall much shorter of 4% of GDP committed by the government and 7% targeted in National Education Policy 2009. Allocating Rs 17 billion for overall water projects and Rs 30 billion for achieving sustainable development goals (SDGs) against Rs 300 billion for roads speak a lot about “federal government’s commitment to uplifting health standards”.

Again, no reforms have been announced to tackle structural issues such as falling savings, declining exports, and uplifting private investment. Zero rates on start-ups may not bring the required push, so a compressive reforms plan is required. Presently, three major commodities like cotton, leather, and rice make about 72% of total exports of the country in first 9 months of the fiscal 2016-17. Similarly, approximately 60% of exports are destined to Organisation for Economic Co-operation and Development (OECD) countries which are going through a phase of sluggish growth compromising their capacity to import. Budget 2017-18 offers no clear reforms in this regard. Textile sector, which is supposed to be the backbone of Pakistan’s exports, needs much more than that of the announcement of permission to open warehouses abroad. You may include in the list missing steps for low cost energy supply to industry and reforms to simplify tax filing and tax repayments as well.

Second, how does the government envision future structure of economy, particularly what does budget 2017-18 offer for sustained institutional reforms to promote tradable sector - the exports?

The criterion is selected purposefully. Tracing back, Pakistan has historically been taking pride in “consumption based” economy status and followed indigenous growth model where import substitution has been the focus of economic growth strategy/policy.

It has broader implications ranging from employment to investments, from fiscal deficits to public borrowing and from FDI inflows to current account deficits. I believe that not only good export promotion policy can help meet the challenges of economy at multiple fronts listed above but also envisioning China Pakistan Economic Corridor (CPEC) in true essence is about envisioning future exports of Pakistan.

Other than a tax holiday of start-ups, budget 2017-18 has not much for industry. The budget clearly shows a reluctance to accept the structural flaws behind secular decline in exports and the “global slowdown” and “reduction commodity prices” remain the two chief culprits pointed out. The budget though offers zero rating to some industries, a clear reflection on the structural hurdles is missing.

For example, exclusive focus on energy production ignores the high cost energy production raising the production cost resulting in loss of already lower export competitiveness. Implementation of conventions of Generalised System of Preferences (GSP) may support boosting exports but budget 2017-18 is silent on the improvement of labour and environmental laws.

Third, what do we learn from past performance?

A good budget must be forward looking but it must be based on the lessons from the past. The lessons in this regard are not learned well, if Pakistan economic survey is the guides. The latest economic survey reports an overall economic growth of 5.28 per cent, missing the set target of 5.7 per cent by 0.42 percentage point. Let's admit that the rate is highest in the last 10 years and that increase in GDP growth compared to last fiscal year 2015-16 is a healthy sign. However, one notices that almost all the neighbouring countries like India, Sri Lanka, and Bangladesh, with similar economic structures, actually outperformed Pakistan with growth rates of 7.1 per cent, 5.3 per cent, and 7.2 per cent respectively.

More important, however, are the foundations of the acclaimed economic performance. A deep scrutiny raises certain questions on the nature of economic growth and other major indicators registering improvement. The government must be grateful to services sectors for making the growth rate 0f 5.28 per cent possible. The industrial sector contribution to GDP is about 21 per cent, but this sector registered a growth of 5.02 per cent which is less than the previous year growth of 5.8 per cent. It also missed the set target of 7.7 per cent by 2.7 percentage point, which is a huge miss.

Most importantly, large-scale manufacturing sector recorded a growth of 5.46 per cent and failed to meet the set target of 5.9 per cent. The major contributors in the outgoing year to large-scale manufacturing remained sugar (29.33 per cent) and tractors (72.9 per cent). Interestingly both belong to agriculture sector. Growth of small industry, a major source of employment and livelihood for unskilled and low skill labour, has been stagnant at 8.2% for last three to four years.

The services sector contribution to GDP growth fall from 70 per cent in FY2015-16 to 59.59 per cent in FY2016-17, though the sector grew at 6 per cent rate surpassing the set target of 5.7 per cent. Among the subsector of service, wholesale and retail trade sector, contributing to GDP 18.5 per cent, registered a growth of 6.82 per cent against the set target of 5.5 per cent while the second major subsector of service (transport, storage and communication) missed its target of 4.82 per cent whereas the realized growth is 3.94 per cent.

Agriculture sector has always remained one of the most important sectors of economy. It is soothing to note that agriculture sector registered a positive growth of 3.47% meeting the set target. The government claims that this impressive growth in agriculture sector is made possible due to its policies and agriculture credit disbursement. Nonetheless, it ignores the structural problems of the sector.

It sounds good to count Rs 1001 billion allocated to agriculture in budget 2017-18 as compared to Rs 700 billion in the previous fiscal. Also, it is encouraging to see the credit rate dropping to 9.9% for small farmers (owning less than 12.5 acres). Nonetheless, one needs to notice that this mark-up paid by poor farmers is still highest in the country. Also, it is not clear from the budget that what will be the credit mechanism for tenants, as they don't own any piece of land. This is particularly important in the context of announcement of linking land record to Stat Bank of Pakistan so that farmers might get credit avoiding collateral complications. Similarly, subsidy on electricity for agriculture tube wells goes to big land holders, as the poor farmers can't afford these tube wells. Same holds true in the import of combined harvesters. Mechanisms need to be in place to ensure that subsidies on agriculture inputs reach to those who are in maximum need.

The export sector has also registered a declining trend (total exports fall by 3.06 per cent during July-March 2016-17). This decline in exports happens despite the several promotional measures announced in the Strategic Trade Policy Framework taken by the incumbent government like the establishment of Exim Bank, the reduction of mark-up rate on Exports Refinancing Facility (ERF) from 9 per cent in 2010 to 03 per cent to-date, the establishment of service trade development council by the Ministry of Commerce along with the reduction of Long Term Financing Facility (LTFF) from 11.4 per cent to 06 per cent. This shows the failure of the regulatory policies. At the same time, however, one needs to bear in mind that the overvalued rupee is posing the most serious challenge to exports of the country.

Also, the government has proclaimed a sizable increase in tax revenue as success story. This was, however, achieved via indirect taxes, which are regressive by their very nature and should not be something to celebrate. Indirect tax is 57 per cent of total taxes while sales and excise taxes as per cent of indirect taxes increased from 68.7 per cent to 69.7 per cent and from 9.9 per cent to 10.3 per cent in the fiscal year 2016-17, all of which are not a healthy sign for the tax structure of the economy.

Furthermore, growth in sales and excise taxes (both are indirect) recorded as 1.45 per cent and 3.1 per cent respectively in the previous fiscal year, is directly related to widening inequality in the society. It is important to note that in absolute terms that the tax to GDP ratio had not increased by the desired levels in the last fiscal year, so it stays in narrow band of 11-12 per cent of GDP. The ratio must be about 2o per cent for a growing economy and, as a quick reminder that this increase must come from direct taxes and tax-net widening-not from indirect taxation.

In terms of financial capital inflows, net FDI increased from US$ 1.4 billion to US$1.6 billion showing an increase of 14.8 per cent in first nine months of fiscal year 2017. However, one should not forget that 37.1 per cent of the overall inflows during fiscal year 2016-17 came from China. In the first 9 months of the fiscal year 2016-17, total FDI stood at $1610.6 million in which China's share is $744.4 million. Most importantly, FDI by China is strategic by its very nature and does not reflect the "efficient destination" status of the country for foreign investors.

FDI into sectors such as agriculture and mineral resources (oil, iron, titanium, aluminium, coal and gas, gemstones, copper, and gold) is the most crucial need as of now. Pakistan is an agro-based and resource rich country, and thus has a large export potential in this sector. Also, the advancement of technology and enhanced value-addition seems a missing priority in the budget 2017-18.

The discussion corroborates that the relief in economy is not coming from improvement in the basic structures of the economy. A decline in exports despite the increased energy supply (relative to previous years) and lowered the cost of production (low oil prices comparatively) suggests the structural flaws in the economic structure of the country. Per barrel price of oil declined from $125 first quarter of 2012-13 to $49.04 on May 26, 2017 shows a fall of about 61 per cent. The cost of production should have declined significantly as oil makes major source of energy in Pakistan.

Similar indication can be drawn from declining fixed and private investments. Private investment declined from 10.2 per cent of GDP to 9.9 per cent of GDP in fiscal year 2016-17. This was despite the fact that SBP has announced historically lower policy rate of 5.75 per cent. Despite better security situation and record low interest rates together with greater access to credit, the government missed the set targets of investment. A plausible explanation is that the cut in the interest rates primarily served as low cost borrowing for the public sector. Domestic debt during the first nine months of fiscal year 2016-17 increases by Rs 1121 billion.

A success story often told by the government is the all-time high $21611.7 million of foreign exchange reserves of Pakistan. However, we must examine the sources of these reserves. Firstly, a major increase is due to a fall in oil prices and a sustained inflow of remittances from abroad. I will not cover the details of donations/loans making part of these reserves, as they are out of our scope. Secondly, the sustainability of these reserves can be better judged within the context of declining exports in the most recent period. There is also a need for a careful examination of the rise in debt and these reserves over the duration of the incumbent government wherein the former out-classes the latter. Finally, the rupee appreciating impact of these reserves, when actually exports are falling, must be a serious consideration.

Aforementioned discussion stresses that despite improved economic performance, there are massive structural weaknesses which need to be tackled. Gains need to be consolidated. Focus needs to be shifted now from stability to sustainability of the economy. The existing set of policies and the patterns of budgeting cannot bring any fundamentally sustained outcomes - as more of the same always gives the same result.

Part 2

Indirect taxes to impair poorest of the poor

By Dr Vaqar Ahmed

The budget speech delivered by Finance Minister Ishaq Dar in the National Assembly on May 26 was certainly not driven by considerations of human and social development. Not once did he mention that income inequality, job creation, access to affordable factors of production (including energy), is a serious issue in Pakistan. Unfortunately, the plethora of indirect taxes and withholding taxes (also collected in indirect tax mode) continue to accentuate income and consumption inequalities. This year again over 60% of revenues of Federal Board of Revenue are envisaged to arrive from indirect taxes.

A rational budget formulation process should aim to reduce inequalities through phasing out federal excise duty, simplification of general sales tax (GST) regime and reduction in GST rates, and lowering of customs duties faced on inputs and finished goods used by the poor. Recent literature on tax incidence also suggests that reducing indirect tax has a pro-poor impact if relief is provided in consumption of food, fuel, cooking oil, bread, milk, fruits, tea, sugar, and vegetables. Table 1 indicates changes in prices envisaged through proposals of budget 2017-18. Unfortunately, these items do not include the commodities intensively consumed mostly by the poor.

Table 1: How indirect taxes will impact prices faced by the poor?

Type of Indirect Taxes	Increase in price	Decrease in price
Sales Tax	Steel, textile, leather, carpets, surgical and sport goods, imported fabrics, locally produced coal,	Poultry machinery, combined harvester, diesel engine, imported seed, LED lights, mobile phones
Federal Excise Duty	Cement, cigarettes	Telecommunication services
Extra tax		Lubricating oils
Withholding income tax		Mobile phone subscribers

With the imposition of general sales tax on services (by provincial governments), there are also issues of double taxation faced by small and medium enterprises. The proposed federal budget did not address how this double taxation could be avoided. Apart from this tax, SMEs are facing over 50 taxes, surcharges and levies annually. Only a consolidation or merger of several taxes can render a reduction in cost of doing business.

The Tax Reforms Commission (TRC) of 2014 had noted the rising number of cases of fake invoices, under invoicing, and illegal adjustments. Federal government was asked to lay down an appropriate procedure to deal with all such irregularities. We observe in the proposed Finance Act that tax administration reforms, as per the direction provided by TRC, seem missing.

The TRC had also directed that the overall share of indirect taxes should be reduced and tax based broadening measures should be expediently implemented so that greater share of revenue could come from direct taxes. Unfortunately, this did not happen. Even most direct taxes are being collected through withholding measures which are also in indirect tax mode. It was earlier suggested by the SDPI experts that Pakistan should follow example from Turkish revenue authorities which were able to double tax-to-GDP ratio during the period between 1995 to 2006. This was accompanied by a reduction in share of indirect taxes. By 2002, the Turkish revenue authorities had abolished 16 indirect taxes and introduced a special consumption tax levied on items most consumed by the rich. Similarly, progressive taxes on property, inheritance and gifts, were increased. Given the industrial expansion, an environmental tax was imposed which was earmarked for enhancing expenditure in social sector.

Another matter of concern is the growing number of indirect tax exemptions being allowed to select sectors and entities (Table 2). Since the past year, these exemptions have grown by 5.4%. The budget documents or the previous year's economic survey do not provide any tax incidence or welfare analysis of such exemptions, which could inform us regarding gainers and losers from the forgone revenue.

Table 2 Federal Taxes: Tax Expenditure and Exemptions (FY 2017)

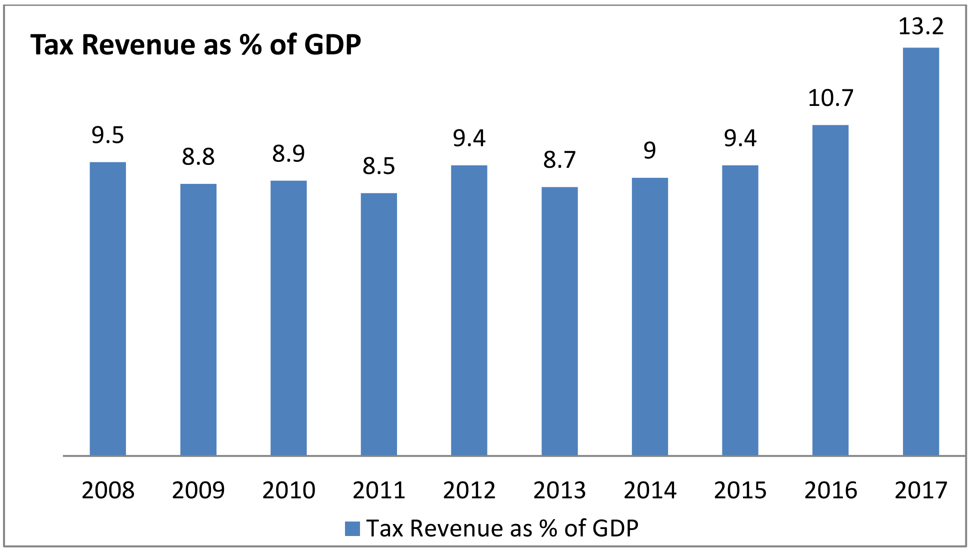
Type of Tax	**PKR billion**
Income Tax	14
Sales Tax	250
Customs Duty	152
Total	**416**

Finally, this budget will maintain the high cost of compliance faced by taxpayers. This is a clear disincentive to those who are under the formal business regime. They face unfair competition from those operating in the undocumented sector. Currently, multiple tax returns have to be filed with multiple revenue authorities at the federal and provincial level. Similarly, multiple authorities send various audit notices to the same taxpayers. SDPI and several business associations, including Pakistan Business Council, had suggested that there should be a single return and common collection of taxes in order to bring down the overall compliance costs.

Tax revenues in Budget 2017-18

By Rabia Manzoor and Ahmad Durrani

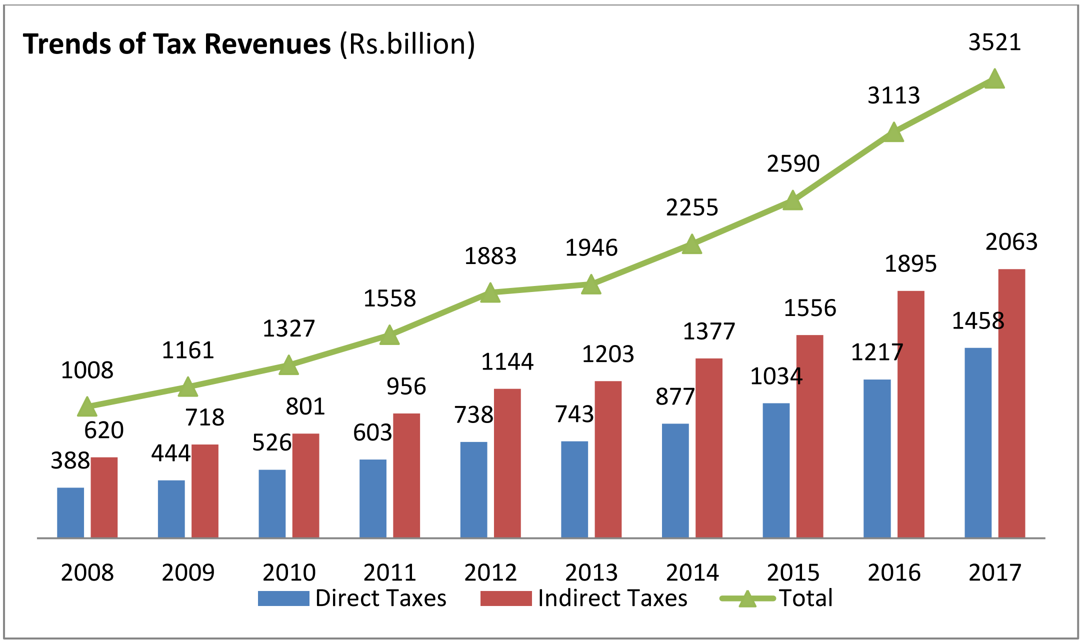
Until fiscal year 2015-16, the overall tax-to-GDP ratio varied between 8 to 9 per cent of GDP. However, by the fiscal 2016-17, the overall tax collection as percentage of GDP improved significantly, i.e. 10.7% of GDP. In the current fiscal, it is likely to increase to 13.2% as depicted in the figure below:



Source: Pakistan Economic Survey 2016-17

This increase in tax revenue is a positive sign of development. Unfortunately, the major portion of this increased revenue has been in the form of indirect taxes in Pakistan, which, in excess, has deleterious effects on economic growth. According to economic theory, indirect or regressive taxation disproportionately burdens the poor compared to the rich. Indirect taxation also reduces their level of disposable income for consumption. Since a major portion of domestic consumption is driven by incomes of the poor, an increase in indirect taxation is likely to have an adverse effect on economic growth.

Over the years, Pakistan's tax structure has become heavily dependent on indirect taxes. Last year, it has seen a decrease in indirect taxes compared to direct taxes for the first time in eight years. This transition has primarily stemmed from the success of various tax reforms such as broadening the tax base, rationalizing tax rates, simplifying procedures and strengthening tax administration. Thus, in FY 2016-17, the proportion of direct taxes increased to 43.4% of total revenue whereas the share of indirect taxes fell to 56.6% of total revenue. For the current FY 2017-18, the target of tax revenues is Rs 3,521 billion, but in 2013, FBR collection was Rs 1,946 billion. This represents a historic increase of 81% during the last four years with an average annual growth of 20% as shown in the figure below:



Source: Pakistan Economic Survey 2016-17

During the outgoing fiscal year, the bulk of direct taxes was collected through income tax. Major contributors of income tax include withholding tax, voluntary payments and collection on demand. The share of income tax within total direct tax revenue is around 99%. On the other hand, indirect taxes mainly include sales tax, federal excise duties and customs duties. Sales tax is the largest contributor constituting 43 per cent of total tax revenue and grew by 22 per cent during 2015-16. Out of total net sales tax collection, more than half (52 per cent) of total sales tax is contributed by the sales tax collected on imports amounting to Rs 684 billion while rest is collected from sales tax on domestic products. Customs duty contributed around 20% in indirect taxes and 12% in total taxes. All these indirect taxes are putting greater burden on the low-income households.

Taxation system in Pakistan needs to be revamped by reducing gap between direct and indirect taxes, increasing number of taxpayers, efficiently collecting income tax, and reducing compliance and administrative costs.

Need to revisit 'filers and non-filers' discourse

By Shafqat Munir

The budget and post-budget speeches of Finance Minister Ishaq Dar single out non-filers to be put to punitive measures in the interest of 'bringing more people in the tax net'. In his post budget speech, the minister, in a bid to justify his tax agenda, i.e. withholding tax and advance tax measures in the budget 2017-18, said that the government has not put any tax burden on common citizens rather steps have been taken to net the non-filers. This statement of the minister reflects that as if all the non-filers are rich tax evaders.

The term filer/non-filer was introduced a couple of years ago to identify tax-payers and tax-evaders. But, the two categories have not been sub-categorized, especially the most maligned one - the non-filers. There is a need to examine whether or not the non-filers are homogenous and all are liable to be put to punitive actions by imposing an increased tax ratio. This should not be discussed just as an issue of hard core economy, but it should be seen in the light of the political economy perspective.

According to section 114 of the Income Tax Ordinance (ITO), the people who own immoveable property with a land area of 500 square yards or more, a flat having covered area of 2000 square feet or more, and a motor vehicle with an engine capacity above 1000CC are bound to file their income tax returns. Earlier, there has been some more such requirements. Till May 23, just three days ahead of the announcement of the federal budget, 1.158 million Pakistanis filed their Income Tax returns, just a fraction of the adult population.

Even if we do not compare the total population which is estimated to be more than 200 million, let us just take those who use mobile phones and Internet as the population to be compared with the ratio of tax return filers. For political economy analysis of filers and non-filers discourse, let us take the users of 140 million SIMs (according to economic survey 2016-17) who use mobile phones to make calls and users of 42.5 million Internet connections who use Internet either on their smart phones or on their computers/laptops. Many of them may overlap the total figures, so both figures are not being added to make it a total figure.

A total of users of 140 million mobile phone SIMs (93 million users, each one of them have 1.5 SIMs in use) during the current fiscal year (2016-17) have been paying 14% advance tax on their bills in addition to regular tax (15%). In a sense on each Rs 100 bill, they pay Rs 29 as tax. Similarly, 42.5 million people on each Rs 100 for their Internet bill, pay Rs 29 as tax (14% advance tax and 15% regular tax). It is to be noted that 14% advance tax both on use of mobile phone and Internet is supposed to be returned to the consumers upon filing income tax returns.

Now by all practical means, only 1.158 million people have the opportunity to get their 14% advance tax on Internet and mobile phones bills back through filing of income tax return whereas the users of 138.263 million SIMs (92.175 million users) are non-filer mobile phone users and the users of 42.5 million Internet connections are the non-filer Internet users. Both kinds of users may be the similar people that is why we cannot add them together rather mentioning them separate. Since they do not file income return (being not qualified) do not claim their 14% advance tax back. If we calculate this unclaimed money which goes to the government kitty unfairly runs into billions of rupees.

Out of the users of 138.263 million SIMs (92.175 million users) fall into the category of non-filer cell phone users, according to an estimate, hardly 2.175 million people would fall under the category of to be potential filers as defines the section 114 of ITO. This means a net of 90 million people would still remain non-filers as they are the low paid people from working class/common people who use cell phones for connectivity and do not own any moveable or immovable properties or taxable income. Similarly, out of users of 42.5 million non-filer Internet users, some 12.5 million may fall in the category of to be the potential filers, hence 30 million Internet users may not be eligible to come under the ambit of section 114 of ITO and to be pushed as filers.

For political economy analysis, if we assume that 90 million non-filers who are not willful non-filers rather they do not have enough income or properties to be pushed to become filers have to pay 14% advance tax on their mobile phone bills, similarly 30 million same non-filers have to pay 14% advance tax on their Internet bills. They do not have any means to get their advance tax back as the filers do. So, the money deducted as advance tax from them goes to the government kitty as unclaimed. Suppose, 90 million phone users being the poor non-filers (not eligible as filers) on an average spend Rs 300 per month on use of mobile phone SIMs, the total amount collected as 14% advance tax (fiscal year 2016-17) stands at Rs 3780 million, while @ 12.5% advance tax (fiscal year 2017-18), this amount stands at Rs. 3375 million. With this monthly average, during the fiscal year 2017-18, the government would fetch Rs. 40,500 million from 90 million cell phone users; they are indeed common persons non-filers using mobile phone SIMs.

Similarly, if users of 30 million Internet connections being the poor non-filers (not eligible as filers) on an average spend Rs 500 per month on the use of Internet, the total amount collected as 14% advance tax (fiscal year 2016-17) stands at Rs 2,100 million, while @ 12.5% advance tax (fiscal year 2017-18), this amount stands at Rs 1,875 million. With this average, during fiscal year 2017-18, the government would collect Rs 22,500 million from common citizens, or non-filers using Internet. Hence the total amount, with this meagre estimate, the government would collect Rs 63,000 million for no reasons. The government had already admitted that last year, it had collected Rs 46,000 million from the unclaimed advance tax from the mobile SIMs and Internet connection users.

Instead of extracting billions as advance tax from the poor, the government should revisit their 'filer and non-filer discourse' as the bulk of non-filers fall in the category of common citizens who have been burdened with unclaimed advance tax. The finance minister also needs to think that in the garb of non-filers they are over taxing more than 50% of the common Pakistani citizens who are not eligible as tax return filers. No doubt, tax base needs to be broadened for a stronger economy, but not at the cost of those who are not eligible as filers, but are being punished in the name of being non-filers. They government should stop collecting this 'unfair' advance tax on phones, Internet, and other such services.

Part 3

Education and social safety nets: a factual analysis

By Junaid Zahid

‘What does the budget offer for common man?’ is the question asked every time after the budget announcement. However, the same can be answered by looking into the fresh orientation of social sector related budgetary allocations and burden of indirect taxes on the common man. Within the social sector, allocations for education and social safety nets can directly impact the lives of the lower and lower middle classes.

For the fiscal year 2016-17, federal and provincial governments allocated Rs 790.704 billion for education, which is 2.83% of GDP. In this regard, the federal government had allocated Rs 108.971 billion for education as compared to Rs 97.88 billion allocated in 2015-16. Education budget for 2016-17 was Rs 84.201 billion and development education budget was Rs 24.77 billion. For FY 2017-18, a total of Rs 132.521 has been allocated for education with a breakdown of Rs 90.516 billion for education and Rs 42.005 billion for development education.

Apparently, an increase of 11.3% in federal education budget for the fiscal year 2016-17 and 21.6% for 2017-18 bodes well yet pessimism can’t be held away because both policy target of spending 7% of GDP for education as set in National Education Policy 2009 and political promise of incumbent government to spend 4% of GDP on education have not been kept.

In fact low allocation is not the issue whereas the issue lies in the release of funds. One third of the schools do not actually receive development funds before the close of fiscal year whereas half of the schools which receive funds do not receive them within the first two quarters. Naturally, performance outcome is expected within the year of budget allocations, but due to delayed disbursement, performance lag creeps in.

In addition, the overwhelming excess of current budget over development budget also reflects the government’s myopic priority of directing its resources to increasing access to education instead of achieving a pragmatic balance of increased access and improved quality.

Social Safety Nets include but are not limited to public spending incurred in lieu of Benazir Income Support Programme (BISP), Pakistan Poverty Alleviation Fund (PPAF), Microfinance Initiatives (MFIs), Pakistan Bait ul Mal (PBM) and Prime Minister’s National Health Programme (PMNHP). Of these, BISP is the flagship poverty reduction programme in terms of scale and budget outlay.

Pakistan Economic Survey 2016-17 mentions some achievements of BISP revealed by an Impact Evaluation Study (EIS) conducted by Oxford Policy Management (OPM) like reduction in poverty gap by 7 percentage points amongst the BISP beneficiaries, increase in consumption expenditure by Rs 187, increase in adult food expenditure by Rs 69 per month. Similarly, it lifts about the increase of cash transfers to Rs 115 billion in FY 2016-17 from Rs 102 billion in FY 2015-16 and increase of target beneficiaries to 5.42 million till March 2017 from 5.29 million beneficiaries in FY 2015-16. Quarterly cash grant per family has also risen from Rs 4,700 in FY 2015-16 to Rs 4,834 in FY 2016-17. For the FY 2017-18, Rs 121 billion has been allocated to target 5.5 million beneficiaries.

But, if one takes into account the increase in food inflation by 3.9% during July-April period of FY 2016-17 as compared to 2.1% during the comparable period in FY 2015-16, the increase in cash transfer grants by Rs 134 seems ineffective. Similarly, the decrease in poverty and increase in consumption expenditures revealed by OPM's EIS coincided with the fall in commodity and oil prices and an upward shock in either one of these can lead to a rise in transient poverty in the short run and chronic poverty in the long run.

Above all, assuming six members per family, the quarterly grant of Rs 4,834 is actually giving Rs 9 per day per member of a family. This petty cash can by no means achieve the goal of drastic poverty alleviation through assets formation.

Apart from these functional imperfections, a recent KAP survey of beneficiaries of Social Protection Schemes conducted by SDPI also revealed that although majority of the poor has cursory knowledge about the SPSs, they don't have any concrete knowledge of the eligibility criteria.

PMNHP was launched in 2016 with an outlay of Rs 10 billion. This year Rs 20 billion has been allocated for the programme. It provides in-patient medical coverage to the enrolled beneficiaries. Real time data on PMNHP shows number of enrolment at 1.07 million who have had made 134,154 visits hitherto to hospitals. It's commendable that data is being uploaded on real time basis but the question is that number of visits – although it is not very high – is not the right indicator to judge the success of PMNHP as it covers in-patient treatments. Actually data of treated patients should be reported. It is quite possible that one patient has made three to four visits. So, actual outreach can't be assessed through this data.

Moreover, the government should think of adding more hospitals on its panel. As its eligibility criteria is based upon the poverty survey conducted under BISP, almost all the panel-hospitals are located in urban centres. There is a need to extend the list of rural health facilities. The brochures of PMNHP have a preposterous mention of providing local transport cost of Rs 350 thrice a year. But if someone in Gujar Khan gets a fracture, he/she can't be commuted by local transport to DHQ Rawalpindi for better treatment.

Instead of plying cheap transportation like Metro within the developed cities like Lahore and Islamabad, it should be linked with under-developed areas of the country.

Common man's plight is not hard to comprehend if one briefly reviews the contours of revenue collection in Pakistan. Indirect taxes made 61% of the much trumpeted revenues collected during the fiscal year 2016-17. Indirect taxation affects those too, who fall below the poverty line. According to a report of Social Development Organisation published in 2015, the richest 10% of Pakistanis contribute 10% of indirect taxation whereas the poorest 10% contribute 16%. On the other hand, direct taxation is regressive in nature, that's why badly impact the lower and lower middle classes.

What impact Budget 2017-18 will create on local and foreign investment?

By Shujaat Ahmed

If one is to look into previous trends of investment as percentage of GDP, there has been improvement in terms of total investment, but on the parallel side investment's contribution in GDP is very much low**.** In terms of total investment as percentage of GDP, it can be observed that there had been an increase over the period with possible reforms strategy (National Doing Business Reforms Strategy 2016) but it didn't proved to be significant. Such steps do not prove to be encouraging for public investors due to high cost of compliance with tax and regulatory regime at federal, provincial and local level, which prevents firms to grow. In addition to the high cost of compliance, weak enforcement of rules of competition and higher sunk costs faced by businesses in entering and exiting markets is also not allowing new investors in small and large-scale manufacturing and value-added sector in agriculture and livestock to grow. It was because of these factors that investment's contribution in GDP growth declined over the past two years.

Budget of 2017-18 has nothing to offer for both local and foreign investors in the long-term as far as taxes are concerned. Corporate tax, ranging from 30% to 35% during the previous year, is still on the high for the potential investors. Similarly, increase in number of years for tax relief will also not be encouraging for both public and private investors. No significant step has been taken for an improvement in starting a business, where energy is one of the primary indicators. In budget 2017-18, Rs 401 billion has been allocated for power sector development, including an investment of Rs 317 billion to be undertaken by WAPDA, the government only focuses on projects like LNG-based power terminals, Neelum-Jhelum hydro power project, and Tarbela hydel power to be more specific. There has been no significant allocation for improvement of quality and efficiency of energy sector. Factors, which should be included in this regard for efficient and quality energy are introduction for systems to reduce number of days from starting of application to installation of system and quality of services, including outages, restoration, regulation and communication.

For coming years, more dependence is on investments in infrastructure and energy-related projects with little efforts being done towards improved innovative investments, e.g. only Rs 500 million has been allocated to Innovation Challenge Fund (ICF) with special focus on the use of technologies and Small & Medium-sized Enterprises (SMEs). Besides the ICF, setting up a fund of Rs 3.5 billion at the central bank has been proposed in the budget 2017-18 for SMEs under risk mitigation facility.

The steps taken in the current budget have very little to offer for investors in terms of reforms which will help in easing the cost of doing business. Incentives have been offered only for the new companies which are entering into the market. The incentive has been offered in the form of tax relief for a very short period of time (i.e. three years).

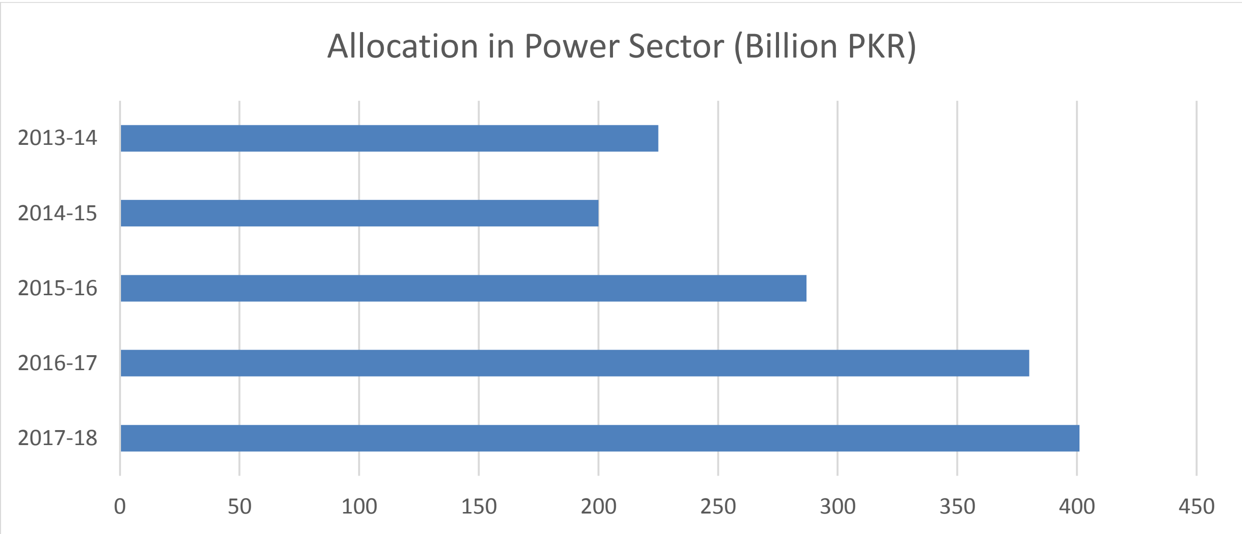
This budget didn't offer anything for improving the cost of compliance which can help investors step up and sustain. Similarly, nothing was offered in the form of cost of entering in to the market due to additional tax measures, which also goes down to district level. As far as the budget and monetary policy document is concerned, only a low interest rate will not serve the purpose. This lowering of interest rate has only increased the private sector credit resulting in very low growth of investment as percentage of GDP over a period of four years. As this budget only played around with the number on tax and tax relief to promote local and foreign investment, there should be a reduction in number, rate and type of direct taxes. Similarly, budget didn't highlight the balance in tax contribution by different sectors of the economy. This balance is needed to alleviate the manufacturing sector from what comes out as an unjustified burden of taxes as income from agriculture and services sector remains out of the tax net. This budget should have proposed a careful review of taxation on inputs to provide relief to major sectors like agriculture where farmers are also subject to GST and customs duty. For the industry, a level playing field for SMEs need to be in place and steps should be taken for the encouragement of SMEs by providing exemptions and preferences in the tax code. This budget should have also looked into administration of revenue authorities. Fear of intrusion by authorities prevents private sector entities from declaring all of their activities and even fear to enter the market and invest.

Budget 207-18: A circular debt perspective

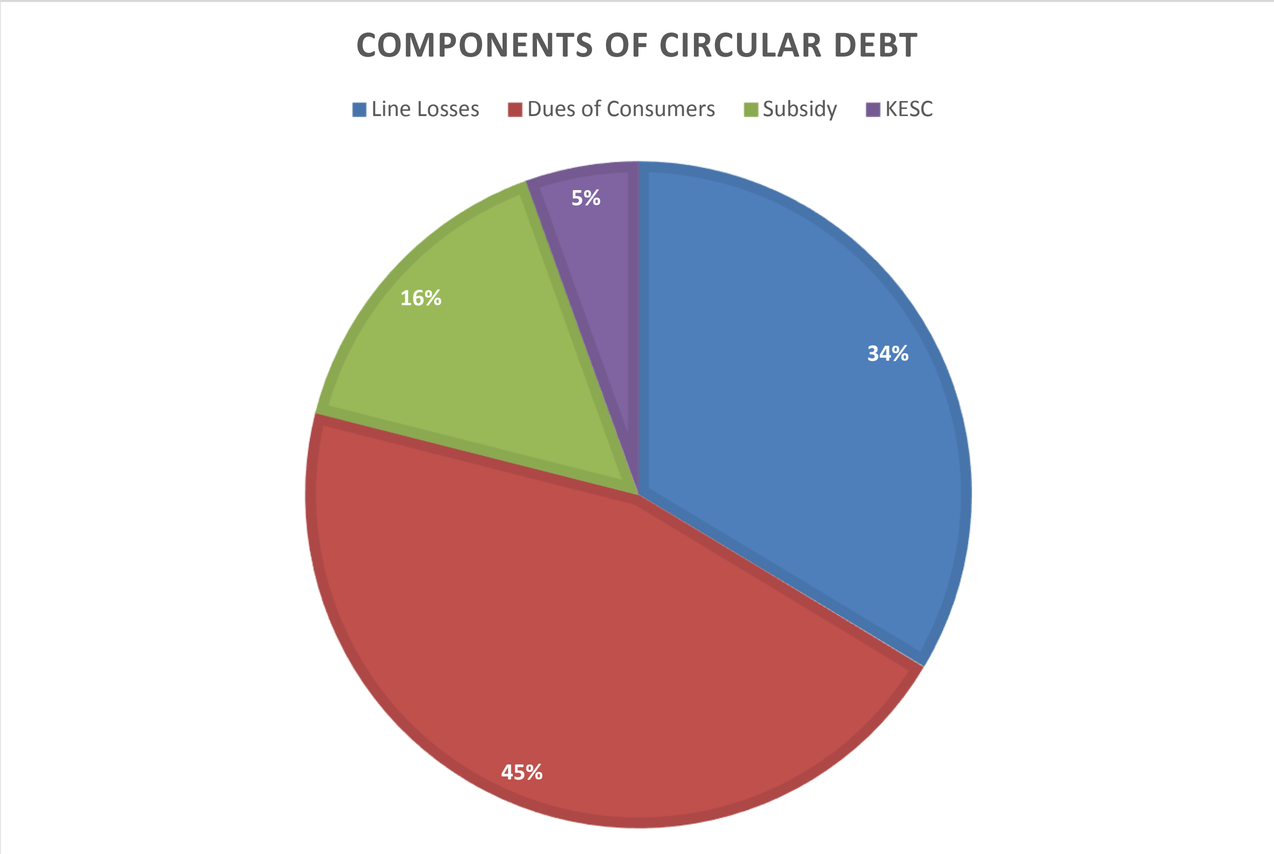
By Ahad Nazir

Despite an increase in budgetary spending for PSDP (power sector projects) by more than 152% and an addition of around 2.6 GW to the national grid, severe electricity shortfall was witnessed in April and May 2017, which hit the major sectors of economy. This shows the lack of vision and commitment towards power sector governance. In this regard, it is important to have a look into what Budget 2017-18 offers for energy sector.

The current political setup has increased the power sector allocations as shown below. Majority of the allocations are external loans. Though power plants infrastructure has been enhanced, the transmission lines and distribution system still need more focused efforts.

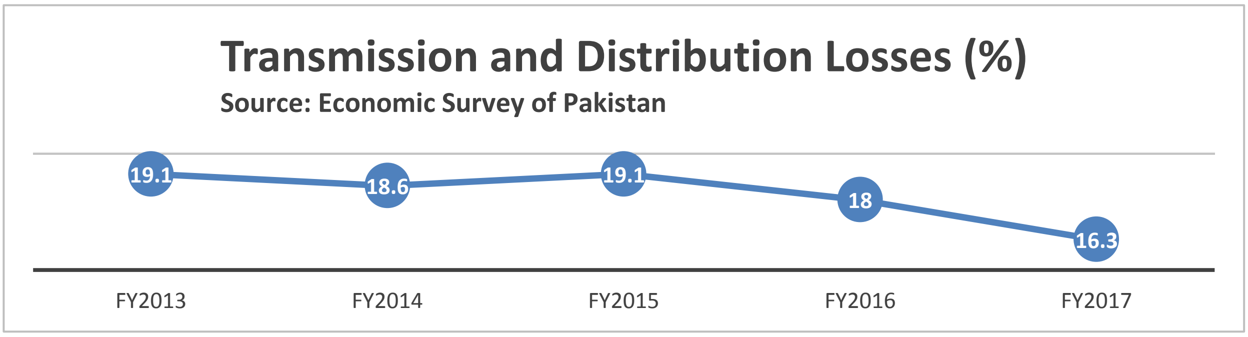


According to the Ministry of Water and Power, the circular debt has again risen to Rs 401 billion with major contributing factors as shown below. Previously, the debt of around Rs 480 billion was cleared



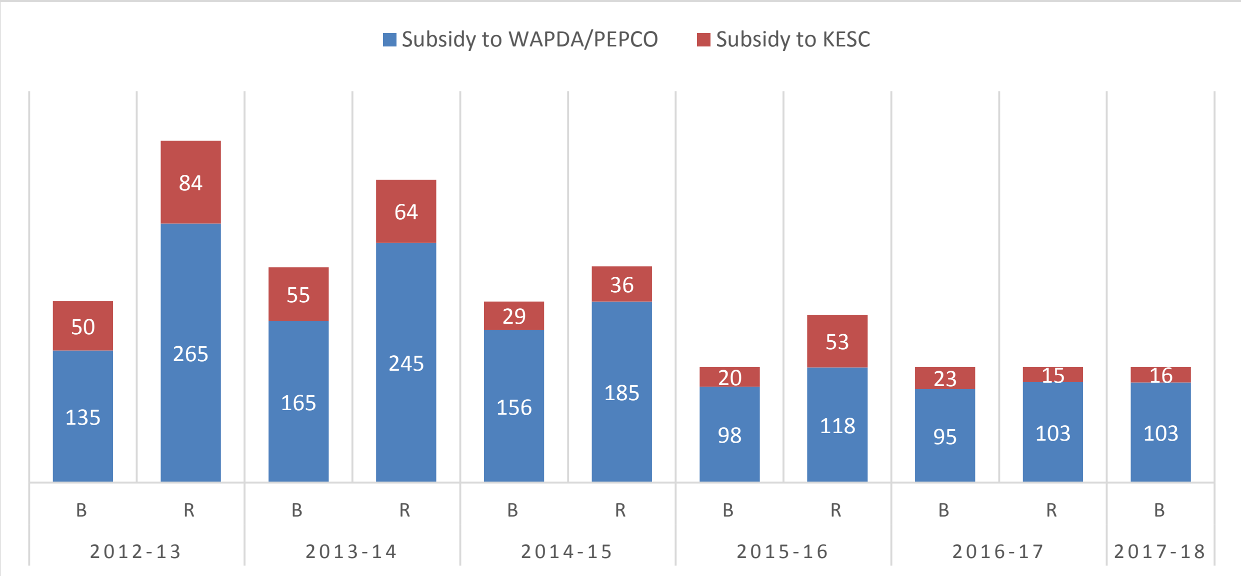
by the government. The government has also reported a decrease in subsidies provided to PEPCO and KESC, increase in recoveries from the consumers, and decrease in line losses. This would reduce if not eliminate the circular debt, however, there is a need to control the situation through policy intervention.

Amongst the factors contributing to the circular debt, the government figures show an increase in recoveries, i.e. 94.4 %, from end consumer, which is a good sign. Also, transmission and distribution losses have reduced to 16.3% of the generation capacity in March 2017 from 19.7% in 2012. Experts believe that the figure is still around 25% of the generation capacity. In comparison, Bangladesh has reported losses of 11.36%, which stresses the need for further improvement in this area. The line losses reported from 2013 to 2017 are provided below. The government has allocated around Rs 125 billion for the transmission and distribution system. These funds are usually re-allocated during the fiscal year to power generation projects. Still, further improvement in grid network and optimization

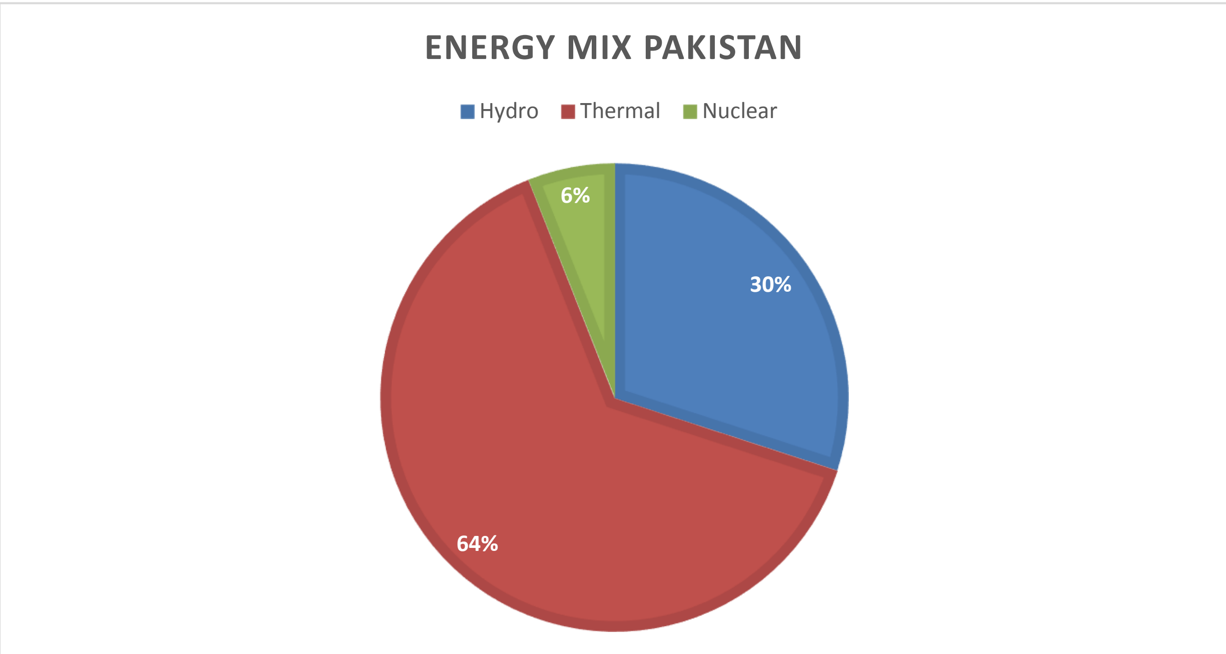


of voltages used in transmission and distribution systems can greatly reduce these losses.

Additionally, the subsidies provided to WAPDA/PEPCO and KESC are also a significant contributor to circular debt. The amount of subsidies budgeted over the last few years was subject to high budget overruns. The overrun was majorly contributed by the inter-DISCO tariff differentials. The government has eliminated the overrun by lowering the subsidy given to KESC. The same value of subsidy (Rs118 billion) has been budgeted for the power sector in 2017-18. The subsidies budgeted and actually disbursed to WAPDA and KESC (in Billion PKR) are provided in the figure below.



Secondly, Pakistan is blessed with natural renewable resources, which can help generate clean energy. The major areas of interest should have been hydropower, wind power, solar power and biomass based plants. The current budget does have allocation for the hydro power project with Neelum-Jhelum project to be completed within this year. However, still the energy mix currently



reported, provided in the figure above by the government, is sourced majorly by thermal fuels (oil and gas based) which is not only an expensive source of power due to the fuel price but also increased the maintenance costs. This shows the lack of focus towards the clean energy sources. The hydropower potential reported by NEPRA is around 41.7 GW whereas only around 6 GW is being utilized. Though the government has shown interest in mega hydro projects, the political interventions and misperceptions associated with these mega hydro projects may also be taken into account. Therefore, the construction of small and micro-hydro power plants is the need of hour. This way the perennial flow of water in most parts of Pakistan can be tapped and this can also be used to reach the non-grid areas. In comparison, India has constructed more than 3200 small, medium and large dams since 2012. The dams produce electricity as a bi-product and can significantly impact the agriculture sector in a positive way and can help avoid or mitigate the impact of floods.

Thirdly, the government should enhance focus on sustainable and green energy initiatives such as wind, solar and biomass technologies. While experts point out around 50 GW of wind energy potential only in Sindh corridor, 290 GW of solar potential and 5 GW potential of biomass, Pakistan is only utilizing around 600 MW of this potential yet. The figure may increase to around 1,500 MW by the end of next year. In comparison, India gets 7.7% of its energy from renewable sources. One of the issues in this regard are the high volumes of fine dust accumulation and high temperatures in the high wind and solar potential regions which can be sorted out by the use of anti-dust and high temperature versions of solar and wind power equipment. Additionally, solar power may also be used to reach out to non-grid areas of the country especially in Balochistan. Also, the incentives for local industry to make it able to manufacture the clean energy equipment should be made part of the government policy. This will consequently reduce the capital cost of power plants, increase foreign investment, build capacity of local manpower, and reduce the cost of energy.

With additional investment allocation primarily focusing on generation rather than distribution and transmission, the problems stated above will remain unsolved and the energy sector will remain unsustainable unless root cause of the issue is addressed.