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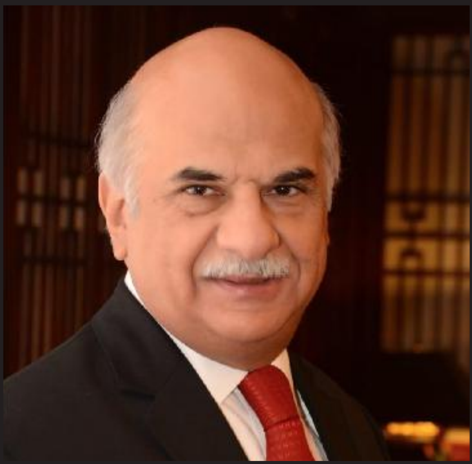

"The recurrent and development budgets should be closely aligned."

- Mr. Muhammad Jehanzeb,
Deputy Chairman, MoPDSI

"We are going to increase development expenditures significantly. If all goes well, you will see this will be a development budget."

- Shaukat Tarin,
Minister for Finance and Revenue

TAX, EXPENDITURES, AND DEBT: TRICA OF BUDGET CHALLENGES

PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS

PIDE P&R

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Pakistan Institute of Development Economics (PIDE)

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PIDE Policy & Research is a guide to policy making and research. Each issue focuses on a particular theme, but also provides a general insight into the Pakistani economy, identifies key areas of concern for policymakers, and suggests policy action. The publication offers a quick orbit of the country's economy and is a hands-on and precise go-to document for the policymaker, businessperson, academic, researcher, or student who seeks to remain updated and informed. This issue is themed around PIDE's recent research efforts regarding the diagnostic of growth. We welcome contributions from within PIDE as well as from any external contributors.

Disclaimer:

The views expressed by the contributors do not reflect the official perspectives of PIDE.

For contributions and feedback, please reach us at policy@pide.org.pk

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Editorial

A budget for growth

It is budget time. PIDE sees itself as a think-tank of the public, not a fellow traveller of the government of the day. So do its professionals. They had been working on the missing software of high and sustained growth well before the build up of the present growth expectations.The readers will recall that PIDE made public its Reform Agenda for Growth, with the Minister for Planning, Development and Reform present, as a major pre-budget exercise. This pre-budget issue of the P&R broadens the debate to inform the budget makers to move beyond the traditional accounting exercise. It will be followed by a post-budget issue to ascertain the distance covered on the road to reform.

With unsustainably large twin deficits, economic growth in Pakistan touched an historic low in 2018-19. It was pushed into the negative territory by the additional impact of the COVID-19 pandemic in 2019-20. The current fiscal year, 2020-21, has shown signs of regeneration, with healthy recovery in the commodity sectors and related services, besides the much-incentivised construction sector. The Government is now upbeat about the future. The transition from stability to growth has been signalled by the change of guards at the Ministry of Finance, just before the presentation of the federal budget for the next year, 2021-22. A P&R team asks the new Finance Minister Shaukat Tarin a set of probing questions to elaborate on his well-publicised stance on growth. As the Government is promising to redouble its development effort in order to boost growth, another P&R team interviewed the Deputy Chairman of the Planning Commission, Mr Jahanzeb Khan. Away from the party lines, the P&R sought alternative views.Contributing Editors held extensive interviews with Hafiz Pasha, a former finance minister and ShahidKardar, a former governor of the State Bank.

In their own write-ups, the Contributing Editors lay bare the intricacies of tax reform, analyse the distortions in public expenditure planning and implementation, assess the sustainability of the rising debt burden and look at the federal-provincial discord on the next National Finance Commission Award. An interview with the unofficial NFC member from Sindh adds value to the coverage of the ongoing debate.

The budget is being presented at a time when Pakistan has been judged as a laggard in the region, with Bangladesh as the growth leader. It also brings back the memories of the Haq-HAG model of the sixties and consequential interpersonal and regional disparities. The latest book by a Bangldeshi academic has been reviewed to cover this dimension of the debate.

Budget Components

Shaukat Tarin

Minister for Finance and Revenue [2]

[1] For this interview, we gratefully acknowledge the excellent coordination support of Mr Abdul Hadee, SO to Deputy Chairman, Ministry of Planning Development & Special Initiatives.

Q1: M/O Finance started a zero-based budgeting framework; has that exercise yielded any improvement? What about the other frame works for expenditure management such at MTDF and MTBF.

You see I don't think that finance division ever started zero budgeting. We do keep improving budgetary exercise. For instance, we have done performance budgeting and that exercise continues. It's very useful and it allows people to defend their allocation space from the ouputs that they are making and creating. Look, it has been very difficult to convince people. Initially we had to deploy a great deal of our own man power and consultants to go and work with the departments but we have seen that over the years this has been institutionalized. One can still argue whether this is a very complete and comprehensive document but a framework has been agreed and the framework allows people to measure some productivity of expenditures that government agencies are making. And that work continues. We have done this medium term budgeting and this is something that over the last one and a half decades, fifteen years long period that MTBF is a reality. It is taken seriously. It does form part of budgetary documents and budgetary exercise. And another interesting thing that we have done and again this has been institutionalized and it remains operative. It goes to institutional approvals and that is budget strategy paper. So we have done it, we made it, we took it to the cabinet, cabinet had serious discussion on it and subsequently we are making it public. It's on our website and we are defending it before our standing committees of finance. So we are working.

Q2: There was a PRSP in place to monitor resource allocation towards MDGs; is the same being carried out for SDGs and how does provinces comply with that.

The PRSP thing that was an instrument used at the time but what the PRSP has done has really left behind a legacy that continues though there is some delay and that legacy is basically related to monitoring poverty related expenditures. That framework is now in place and some delays with which civil accounts are made available to us and because of that publication is delayed. And we will make sure that it gets updated as soon as possible. But as you are aware PRSP has been succeeded by the Millennium Development Goals. So that's an instrument. Our planning commission and cabinet divisions are the ones who are working on this thing. This remains a focus and we provide resources for that and the small development schemes that are allowed to be executed under Millennium Development Goals to serve and achieve the 29 goals that have been specified under the Millennium Development Goals.

Q3: We are under IMF program with pressures to restrain on non-essential expenditures; How will it happen? How the increased intervention through kamyab jawan, naya Pakistan housing scheme, Ehsaas program, BISP, Sehat Sahulat program and expenditure on vaccine will effect expenditure rationalization for the coming year.

So this is true that we have done many program with IMF and the fact that we repeatedly do so is clearly a reflection of the fact that we have not been able to overcome our structural constraints and keep running into difficulties that require help. Of course IMF program is a program of austerity. It is something that is underpinned on significant fiscal adjustment and stabilizing the finances of the federal government. And suggesting policies that can help bring private investment so that the growth is private sector led. We in this program, that we have done this time, we are over the hump. We have done a great deal of adjustment in first year of the government when the program was contracted. We nearly did it but we were hit by Covid also. So we are well aware of this but look we have bounced back and we are very confident going forward that our economic performance will justify. We will be able to come out of the program successfully so that we don't have to go hopefully next time into the program. This is undoubtedly a challenge how we are going to contain non-essential expenditure and devote more expenditure on such activities that you have mentioned Kamyab Jawan, Ehsas, Sehat that you have mentioned. But we are trying to strike a balance. **We are going to increase development expenditures significantly. If all goes well, you will see this will be a development budget as we are calling it with a very strong focus on development spending and for projects which are either creating employment or creating major externalities of enabling people to do business more efficiently, reduce communication costs and easy access to several to several nationwide facilities such as electricity, gas etc.** So these are the types of things we planned to do on the development side and it is very important that we should contain non development expenditure. We are allowing a bare bomb increases in development expenditures which essentially would mean that there is 1 % or 2% on our current side and a much larger increase on the development side.

Q4: PIDE Reform Agenda for Accelerated and Sustained Growth focuses upon reforming almost every area that directly or indirectly influences economic growth. The agenda specifically calls for unleashing productivity, investment, vibrant cities, markets, openness, creativity, internet access and technology usage. What will be the governments priority areas for accelerated growth in the upcoming budget.

Well I'm very impressed with the work that PIDE has done. We are making broad use of the recommendations which we have found over there. For instance, the growth areas, productivity, investment, vibrant cities, markets, openness, creativity, internet access and technology usage, those are the areas of growth and those are the, I would say, engines of growth. The economic advisory council that we have constituted, your vice chancellor is heading on of the sub groups on domestic commerce and we are counting on him a great deal for this purpose. So all these themes are the themes that we have captured in the sub groups that we have constituted. We are looking forward for the sub committees to present the reports. Some delays have taken place, but whatever reports I have received so far, im closely reviewing those. And we plan to take full advantage of these recommendations in our budget work both the development expenditures and the policy menu that we will be providing in the budget. so good work PIDE and we are truly appreciative of the work that PIDE has done in this regard and we look forward that PIDE would continue to support the efforts in designing the policies that would be more productive and efficient.

Q5: The PIDE working paper No.26 by Nadeem et al states that "Government's footprint on the economy in Pakistan is more than what annual general government spending (22 percent of GDP) suggests. In addition to spending; about 200 State Owned Entities, SROs culture and cumbersome business regulations combine towards a footprint of the government amounting to approximately 67 percent on Pakistan's Economy." What is your opinion on it? Any suggestions for the forthcoming budget.

Well I could not agree more with you on your question and observation about SOEs footprint. I can only say that I'm also determined to significantly cut down its foot print. We have it high on our agenda to take final decisions about the SOEs future. We have a triage under the fund program that is also very useful. but we are formulating the strengthening the institutions framework at present which would help us to deliver on this goal that we have. we would not be tentative in this are as far as objective is concerned, goal is concerned, there is full clarity on all levels. We need to re boo the machinery that has to deliver and do some oiling and fine tuning. So this will be something that is high on the radar and we are going to achieve significant headway in this goal.

Q6: PIDE has done a complete P&R on Civil Services Reform which also discusses the Civil Servants Pensions. In the issue, Naseem states that "the Government just forms the pay and pension commission in which we want to migrate from the pay-as-you-go system to the defined contributed system. But there is huge resistance to reforms and big battle lies ahead". Any suggestions regarding the solution for managing ever increasing pension requirements?

You know we have a pay and pension commission and we are looking forward to their report. They have said that they will do it soon after the budget or within this year. I will hold back my comments until I have a chance to see what the recommendations are. Im confident that the vice chancellor Dr Nadeem ul haq have considerable interest in this area. His recommendations will be before the commission also and hopefully they will give due considerations to his thoughts as well. So I will hold my comments until the pension commission report is received.

Thank you very much and im grateful that PIDE has given me this opportunity to reach out to your leadership and convey the economic priorities that we have setting for the government. Thank you.

Muhammad Jehanzeb Khan

Deputy Chairman, Ministry of Planning Development & Special Initiatives [1]

- Image Credits: The Planning Commission (PC)

[1] For this interview, we gratefully acknowledge the excellent coordination support of Mr Abdul Hadee, SO to Deputy Chairman, Ministry of Planning Development & Special Initiatives.

The government has reiterated time and again its commitment to economic growth and specific packages are given to trigger growth momentum in the economy. Growth framework for next year will be approved in the forthcoming meeting of National Economic Council (NEC). The recently released statistics by the PBS estimates that the GDP growth for 2020-21 is 3.97 percent, which is mainly on account of low base effect in 2019-20, exceptional growth in major crops, rebound in industrial sector and partial recovery in the services sector. I believe a major reason for V-shaped recovery is the positive impact of fiscal and monetary stimulus packages along with emergency support for protection of lives and livelihood for the vulnerable segments of the society. Of course, the policy push in the growth framework for 2021-22 will be evenly balanced and, hopefully, with the roll-back of COVID-19 pandemic and particularly with easing of travel restrictions, the economy will benefit from rebound in business activities. Of course, the government will remain vigilant to monitor downside risks of the economy, particularly developments in the external sector during the FY21[1].

Q1. Do you expect the size of development budget to be large enough to sustain growth?

Economic growth is sustained on the strength of fundamentals such as quality human capital, upscaling of technological capability, industrial competitiveness, sustainable agriculture, strategic trade policy framework, national SME policy, financial inclusion, social protection and, above all, an investment strategy for efficient resource allocations. Development budget is one aspect of investment strategy and its size is determined by various factors including the availability of funds, socio-economic priorities and the growth outcomes of this development spending. The government of Pakistan finalizes its macroeconomic framework in a way that macroeconomic targets and development spending are aligned with the private sector business profile. For the present government, sustainability of economic growth is of prime importance. The size of the PSDP is still being finalized but it will be growth oriented by crowd-in private investments. In particular, within the Planning Commission, the PPP Authority is operationally ready and has developed a pipeline of PPP projects which will also crowd-in investments by the private sector.

Q2. M/o Finance started zero based Budgeting framework: has that exercise yielded any improvements? What about the other frameworks for expenditures management such as MTDF and MTBF?

Zero-based budgeting exercise was undertaken by MoF a few years ago. The main aim was to identify savings. Meetings were held with PAOs across the Federal Government. However, no major savings could be identified. In some cases, positions lying vacant for the past three years were abolished.

MTDF (development framework) exercise was discontinued a few years ago. The linkage between macro-fiscal frameworks in national plans/development frameworks and annual budgets could not be established.

MTBF was introduced with the aim to improve fiscal discipline, link govt plans with strategic budgets, and improve delivery of public services. Medium-term budget strategy paper, fiscal framework, and ceilings have been institutionalized together with results-based budget system. An evaluation is needed to understand which of these systems have resulted in achievement of the three aims.

Q3. PFM Law of 2019 has been promulgated, what is the progress on its implementation and bottlenecks?

The PFM Act promulgated in 2019 and amended in June, 2020, sets the mechanism to establish a Treasury Single Account for unified government bank account structure, set-up an internal audit function to address the insufficient authority given to internal financial control and audit units within line ministries. The legislation earmarked a timeline to develop a Budgetary Manual, improvement in Statistical Capacity, economic forecasting and cash management. Within the Planning Commission, a draft of Development Projects Operations Manual is under review. Let me highlight some of the major implementation progress:

Implementation progress

Improved delegation to PAOs: Abolition of Financial Adviser Organization and promulgation of new Cabinet approved regulations: 'Financial Management and Powers of PAOs'.

- Start of work on implementation of Treasury Single Account: Information on bank accounts collected, new TSA and cash management rules promulgated, new rules of assignment accounts in public account promulgated, and its implementation is underway.

- Bank Manual: Promulgation of Federal Government's Budget Manual

- Start of work on update of General Financial Rules and Treasury Rules: To move forward from the legacy financial rules and comply with the new Act.

- Transparency: Publication of Budget Strategy Paper on MoF's website.

Publication of mid-year budget outturn report and presentation in the Parliament.

- Fiscal Control: Improved budget checks on payroll and pensions. Roadmap for sanctioning of expenditure from Consolidated Fund Account, Pakistan Post, Pakistan Railways, Federal Board of Revenue, State Bank of Pakistan, Central Directorate of National Savings.

- Performance based budget: Presentation in the parliament for the years 2019-20 to 2022-23.

- PSDP: All projects received technical approval prior to tabling in the budget 2019-20.

Bottlenecks

Implementation of Treasury single account – difficult to find signatories of thousands of govt bank accounts.

Slow progress in moving from manual pensions (Pakistan Post Office) to direct credit system for civil and military pensioners.

Q4: There was a PRSP in place to monitor resource allocation towards MDGs; is the same being carried out for SDGs and how do provinces comply with that?

PRSP is housed under the Ministry of Finance where resource allocation are earmarked to monitor implementation of MDGs. The last report published by the Ministry of Finance on PRSP Budgetary Expenditures 2017-18 and 2018-2019 includes the figures of the provinces as well. The Annual PRSP Progress report 2015¬16 also explains the SDGs and PRSP synergy (Section 6.5). Therefore, the PRSP still can be used as a tool to monitor SDGs resource allocation upon publication of latest figures by the Ministry of Finance.

Q5: One of the recommendations by Nadeem et al. in their book "Doing Development Better", published by PIDE was "Reforms of overall budget management system to provide real integration across the development and recurrent dimensions of the budget: Do you agree that there is a disconnect in recurrent and development budget? Budgeting these two separately for a sector has a negative consequence for budgeting.

Yes. We agree that the recurrent and development budgets should be closely aligned. Some steps have already been taken for improved alignment but more needs to be done. We need to define a roadmap which can include:

- Presentation alignment: Divide between recurrent and development budget demands is removed. Each PAO is presented with a single Demand for Grants. Budget presentation should be based on outputs/programmes (for example: Performance based budgeting can become the main budget book)

- Organizational alignment: MoF and project wing of Planning will need to be unified under a single projects' portfolio management system. Also, recurrent and development budgets in line Ministries will need to be unified. The capacity to formulate sector planning and strategic budget allocations in line Ministries needs to be strengthened.

- Legal alignment: Such a system would be needed to be enshrined in the law together with strict rules on movement of funds between outputs/programmes.

Q6: Efficiency of project cycle has deteriorated overtime with its adverse consequences for growth. Project preparation is weak, monitoring is lax and evaluation is nonexistent. Do you agree?

Intrinsically, project life cycle is dependent on many factors, such as capacity of the sponsoring agency, urgency of the matter, political considerations, workload vis-à-vis quality of appraisement, geographic spread of PSDP vis-à-vis capacity of the M&E team, loose or no timelines and above all thinly spread financing due to resource constraints etc., which determines the quality and efficiency of projects at different stages.

However, concerted efforts are being made for continuous reforms and improvement. The initiatives, inter-alai includes; complete review of the Planning Manual 2010, addressing the evolving needs, formulation of critical reforms in consultation with Prime Minister's Performance Delivery Unit, targeting the causes of delays at different stages of project cycle, simplification of the funds transfer mechanism and opening of assignment accounts policy, harmonization of the funds transfer policy for GB, close coordination with Provinces /special areas and enhanced frequency of progress reviews. Moreover, a number of initiatives are being taken or augmented for ICT supported informed decision making. These initiatives include upgradation of the Project Monitoring & Evaluation System (PMES), automation of PC-I&II or IPAS, launching of monitoring Dashboard, introduction of Primavera for effective project management and use of satellite /GPS imageries for supplementing the field monitoring. M&E Framework has been revised, Monitoring Templates have been developed and the Provincial M&E Wings are being associated for building synergies and uniformity in the M&E systems.

Monitoring plays key role in addressing the issues causing delays, course correction, identification of deviations, duplications, variations and risk mitigation of time and cost overrun. The focus of monitoring is on Mega Projects, special initiatives of the Government, projects under revision, slow moving projects and projects assigned by any Competent Forum. Due attention is being given to include projects from all regions and Ministries/ Divisions. A special Monitoring Camp Office has been created for exclusive monitoring of Projects in Baluchistan.

Despite Covid situation, record number of projects have been monitored during the CFY-2020-21 surpassing the combined targets of the past 5 years. Quarterly stocktaking meetings are being conducted at Provincial headquarters /clusters for forewarning the executing agencies, for timely addressing the issues causing delay.
Alongside monitoring, projects' Profiles, Cash Plan, Work Plan and monthly progress are regularly updated. As a result of the multipronged strategy, record number of projects are expected to be completed by the end of current fiscal year coupled with significant time and cost saving.

Q7: We are under IMF program with the pressures to restrain non-essential expenditures; how will it happen? How the increased intervention through Kamyab Jawan, Naya Pakistan Housing Scheme, Ehsaas Programme, BISP, Sehat Sahulat Programme and expenditure on vaccine will affect expenditure rationalization for the coming year?

Addressing the socio-economic issues by no means is a non-essential expenditure. The abovementioned programs are essential for socio-economic uplift of the masses. The programs like Kamyab Jawan provided skill development and entrepreneurship to the youth in the country thus contributing to tap the potential demographic dividend. The programs like Naya Pakistan Housing Scheme and BISP and other programs are not only meant for social protection but also generate employment and may boost demand in the economy respectively. As regards the

pandemic situation, it has not only caused damage to the human lives but has also severely impacted the economic activity. The economic impact of the COVID-19 has been accounted for in the growth projections by the IMF during 2020 where global economy contracted by around 3 percent. The policy measures to mitigate the economic impact of COVID-19 have and will impact the fiscal balances globally and Pakistan is not an exception. Covid-19 has put huge pressure on health infrastructure in Pakistan, hospitals are already working in full capacity. Government's fiscal stimulus package and monetary policy response by lowering the interest rates and improved provision of liquidity, particularly for small businesses have been very instrumental in this situation. Such measures may exert pressure on fiscal space; however, this cost may be outweighed by the long-term impact of pandemic.

Specifically, I would like to point that the IMF has not categorized social sector spending as non-essential, rather it encourages enhanced spending to improve social indicators and even development expenditures are also not part of the targeted primary surplus/deficit calculations which is the main performance criteria for the Fund program. IMF Program Objectives state that, "Protecting the most vulnerable from the impact of adjustment policies will be an important priority. This will be achieved by a **significant increase in resources allocated to key social assistance programs**, supporting measures for the economic empowerment of women, and investment in areas where poverty is high" (IMF Country Report No. 19/212; July, 2019). IMF has also explained program focus in recent IMF report as "It builds on sustaining fiscal discipline while protecting critical social spending, safeguarding monetary and financial stability". So vaccination and other expenditures on livelihood are not a cause of concern as far as IMF program is concerned.

Q8: The PIDE working paper No. 26 by Nadeem et al states that "Government's foo print on the economy in Pakistan is more than what annual general government spening (22 percent of GDP) suggests. In addition to spending, about 200 State owned Entities, SROs culture and cumbersome business regulations combine towards footprint of the government amounting to approximately 67 percent on Pakistan's Economy." What is your opinion on it? Any suggestions for the forthcoming budget?

There is no denial of the fact that the role of the government should be that of a 'facilit tor' and a 'regulator'. And structural reforms are being introduced to gradually creating more space for the private sector. The GoP is cognizant of the huge losses which SOEs are inflicting on public exchequer. Recently a comprehensive triage exercise has been carried out in this regard. The primary objective of the triage exercise was to compr hensively review GOP's existing SOE portfolio to identify the SOEs which need to be r tained by the government and those which should be privatized or liquidated. Although this exercise was limited to commercial SOEs due to the fact that more than 98% of the government's assets and almost 100% of the losses in the SOEs portfolio are related to commercial SOEs.

As an outcome of triage exercise, a Central Monitoring Unit (CMU) has been established in Finance Division. The progress against timelines shall be monitored by the Cabinet Committee on State Owned Enterprises (CCoSOEs) regularly through Central Monitoring Unit (CMU) being established in Finance Division. Progress reporting regarding triage outcomes shall be a regular function of the CMU. While it is important that the Government takes appropriate steps towards downsizing the existing portfolio of SOEs through clearly defined ownership criteria, it is equally important that the SOEs, whether these are retained in the long run or are retained till these are liquidated, divested, or privatized, are managed through introducing appropriate governance framework and oversight mechanisms.

As part of Government's efforts to improve Pakistan's ranking in 'ease of doing business' indicators, the Government is aiming to improve the quality of regulatory environment and promote private investment across the country. As a result of recent business climate reforms, Pakistan's ranking in the World Bank Group's Doing Business Report 2020 has improved by 28 points from 136 to 108 out of 190 economies. Various steps have been taken by the BoI regarding facilitation for starting a business. The Government's commitment to improving the business environment is further manifested in the introduction of Pakistan Regulatory Modernization Initiative, a second-generation regulatory reform effort, which builds on the progress of doing business reforms in the entire country and not just Lahore and Karachi. Key features of this initiative include:

- Legal framework for developing a Federal Regulatory 'Guillotine Act' that eliminates unnecessary business regulations, and adoption of Regulatory Impact Assessment (RIA) to improve regulatory quality.

- Establish a National Regulatory Delivery Office (NRDO) for regulatory oversight to address business grievances and manage flow of regulations.

- A major deliverable of this project is the establishment of an online "One Stop Shop" by the name of "Pakistan Business Portal". This will enable businesses to find regulatory requirements, in respect of different sectors, submit their applications electronically and also pay the fees/charges online to obtain required licenses/permits.

In addition to the deregulations of existing PSEs, Government has always remained keen to involve the private sector in the development pursuits of the country. The Government has taken the Initiative of PSDP-plus, where basic intention is to reduce the pressure on the regular PSDP with the involvement of the private sector. In order to facilitate the involvement of the private sector, an Infrastructure Project Development Facility was established in 2006 which was converted to Public Private Partnership Authority (P3A) in 2017. The primary objective of P3A is to provide an enabling legal and regulatory framework for developing, executing, and implementing P3 transactions, thereby promoting private sector investment towards building public infrastructure and the provision of related services.

Dr. Waqar Masood Khan

Special Assistant to Prime Minister on Finance and Revenue

- Image Credits: Pakistan Today

Q1: FBR Policy Board has decided to make a Tax Policy Unit at Ministry of Finance; PIDE has been vouching for a tax policy for growth; what contours or principles you suggest for Tax Policy in Pakistan.

Tax policy board met in February, and it is decided that dedicated people will be invited for tax policy. Actually, tax collectors are the policy makers and they don't get an opportunity to focus on tax policy alone. That is why a dedicated unit is in the making. It will have fiscal economists, chartered accountants, lawyers and finance graduates. They will analyze tax policy from all aspects and will frame their recommendations. And then as per the process, in the light of these recommendations, the board, different government bodies like ECC and the cabinet meet specially during budget and decisions are made regarding the approval of different tax proposals. The work is in progress. Now what are the principles of tax policy? The basic principle of the tax policy or the centre point of the tax policy should be to ensure that ease is created for the tax payers who are liable to pay taxes so that the tax payers can voluntarily pay taxes. Then tax policy is also used for nudge, though we are not encouraging it, but it is used to create incentives. In important socio economic areas where development is required, the tax policy is used to provide different incentives to attract investments. The unit will analyze all these recommendations. The objective of the corporate income tax reforms introduced under the imf program is to focus on various tax exemptions which can be wither in the form of complete exemptions or concessions in the form of low tax rates. These are not conducive to our tax regime. A huge amount of revenue is wasted because of these which is called tax expenditures. In the last report the tax expenditures or tax costs are estimated to be around 1.1 trillion rs. We have provided every possible different tax exemptions and concessions. We ensured imf that this will be done in this program. We have implemented first part of it. In the next budget decisions related to personal income tax and sales tax will be made. The removal of these concessions will improve the tax regime and tax revenue will increase. As stated earlier, we have to decrease tax expenditure and should not use tax as an incentive as it creates distortion. This is the basic principle behind these reforms.

Q2: PIDE identifies in its Research Report "Growth Inclusive Tax Policy; A Reforms Proposal" that 35 out of 85 withholding tax lines yield insignificant revenue so must be abolished to achieve simplification and reduction in compliance cost to private businesses. How can the existing withholding regime be improved?

This is very pertinent question that we have. A very large number of WH taxes. I want to emphasize that even in the last budget saw a dozen of WH tax withdrawn and we plan to continue this process in this budget also and some 15 to 25 WH taxes are on the block to be chopped. At the same time we have to realize that WH, other than revenue, is adjustable. If somebody is not taxable, or if there is no tax liability, there is to be a refund or it will be deducted from the liability. WH also provide a significant amount of information about tax payers. So what we are going to do is while we will eliminate WH taxes but we will retain the documentation requirement and reporting requirement.

Q3: Track and Trace System is again in a pause due to Stay in court. Is there significant revenue increase expected if such a system will be implemented. Also, what is the coverage of this system; would it cover all the registered sales tax payers.

See Track and Trace is a big ticket item. We had done all the work, we had bad luck previously. This time we had awarded the contract but somehow some people approached the court and obtained stay order. We are vigorously contesting in the court to have the stay reverted. And obviously we are ready to provide all the justifications for reaching the final outcome of the award process. In this track and trace we have four industries that we are covering i.e. tobacco, fertilizer, sugar and cement. These are the four sectors which are targeted in the first place but it has no bounds. The regime will move on as we gain experience from these four sectors. With this all these industries will also benefit. As the spurious productions marketed in the big brand name or illegally without paying taxes will all be checked.

Q4: In one of PIDE's study on "Tobacco Taxes in Pakistan" it was identified that the field formations due to lack of human resources often resort to overriding functions such as audits and revenue collection. Do you see it as a constraint and any road map to plug these deficiencies?

I'm not aware of any such thing as you have mentioned, the lack of human resources as far as tobacco taxes are concerned. You know there is a problem. The problem is of informal sector and we need enforcement as I told you about Track and Trace. We will be able to gain significant ground. Already we are tightening in general the smuggling regime in the country. Anti-smuggling measures have started giving significant, concrete results and we see the local industry coming and congratulating us and admitting that their demand is on the rise because the smuggles goods are not reaching. So we will continue to tighten and because of that even the informal cigarettes and tobacco movements will be checked.

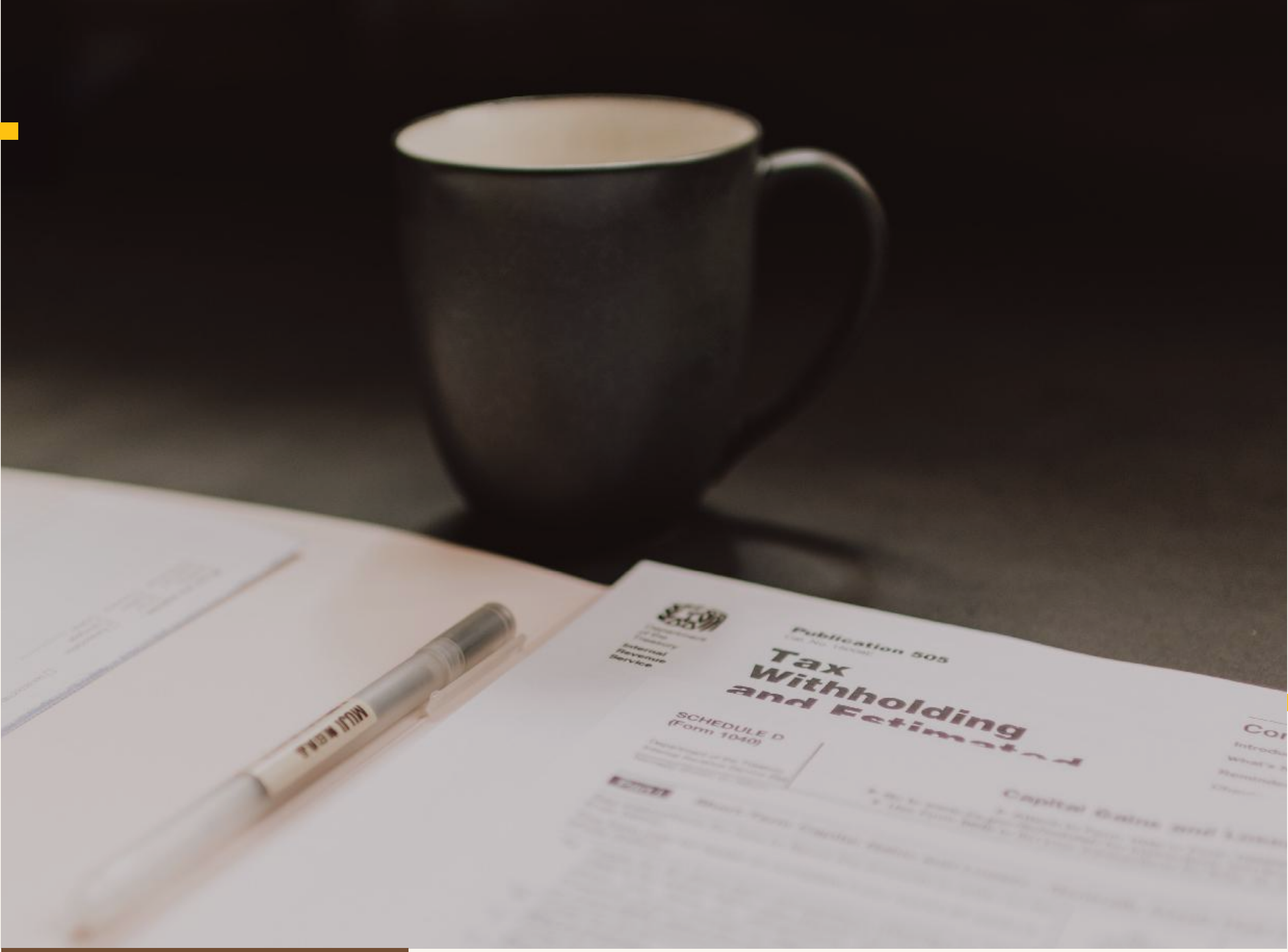
Q5: Budget Strategy paper at Ministry of Finance must be in making. In your opinion what should be the FBR tax revenue collection target for the next fiscal year given economic growth shows visible signs of improvement. The unexpected growth in non-tax revenues and provincial surpluses led to fiscal account improvement last year, what about this year.

Well I don't think it is appropriate to discuss this specific target. This is still a work in progress and we will continue to make improvements in fiscal discipline so there will be fiscal adjustments but then we are passing through a phase in which the first two years are nearly spent in either the demand containment or fighting Covid. Now we are back on track you see 4 % growth has been achieved for this year and we will be targeting even higher next year and all of these things and the some of the features that I mentioned about tax policy will reveal that we will have very good size of the collection next year which should help us in further adjusting our fiscal deficit. You see as far as provincial surpluses are concerned we also don't want to depend on those things but if somehow the country needs fiscal adjustment, frankly, it is just not possible without requesting provinces to postpone consumption. I mean some people feel that surplus means that they have some profits and surplus and they will give it to us physically. NO, it only means that they don't spend that. It is their money, its in their accounts, and they will have time to spend in future so it is only postponement or delay in consumption. And we want to be realistic but we are under the IMF program and we will have to do fiscal adjustment and provinces have to come on board to support that thing.

Q6: Various forums have been proposing reforms for FBR and the overall tax policy. PIDE has been actively pursuing that agenda. What are the key features which will be addressed in the upcoming budget?

We are very closely engaged with many types of industries, businesses, chambers and in particular with Pakistan Business Council, the overseas investment chamber, American Business Council and some others and Federation of Pakistan Chambers of Commerce and Industry above all. And we have held two sets of session with them and many of their proposals are very very good and part of our own agenda so it goes without saying that we will be seeing or meeting each other's expectations. But there are others where we may have some difficulty. In particular, let me say that the key demands are the minimum turnover tax, some duty reductions in import regime and also the profit rates are felt to be still very high, they are around 29 %. So we will see how far we can go and meet these things but these are on the radar and actively under consideration.

I totally agree that we need a single national agency for tax collection because we see investors extremely pained and over extended in meeting regulatory requirements. If there is a nationwide business, it has to file 5 monthly sales returns, multiply by 12 makes it 60 and the compliance costs are huge and very significant and require man power and some expenditures also. So we are working on harmonization until the dream of single agency is materialized. Our current focus is to bring together all the four and five agencies on a single platform so the businesses don't have to file 5 different forms in 5 different portals. There could be a single portal. And we have some issues with the provinces in terms of the definitions of goods and services and origin and destination. We are feverishly working to resolve those. If those are resolves, then we will have harmonized system so in the absence of single agency, the harmonized system will be a great success in at least giving people ease of doing business DOING TAXES BETTER: Shifting The Paradigm of Tax Policy and Administration



Mahmood Khalid

Tax Policy Design And Reform Options

Taxes are involuntary charges levied on individuals or corporations and enforced by a government entity—whether local, subnational or national—in order to finance for government activities. The level and nature would vary depending on the structure of the economy and other goals mandated with taxation system. These other goals are but not limited to redistribution, economic efficiency, intergenerational transfers, pricing, equality, development and others. In Pakistan resource mobilization takes place at federal and provincial government level. Main taxes are broadly differentiated in direct and indirect taxes (with surcharges included in the indirect taxes).

Federal Board of Revenue is the federal entity responsible for collecting major part of tax revenue. A substantial increase in the tax collections has been witnessed during last two decades. FBR tax collection was just around Rs.392 billion in 2000-01 which has jumped to around Rs.4 trillion in 2019-20. Pakistan is under a IMF program and as per news reports Four pending reviews (2nd to 5th) are completed and $500 million for budgetary support will be released very soon. The domestic authorities have adopted some tax policy recommendations proposed by the Fund and it is expected that more changes will be made in the coming days. Some favor these tough steps whereas some have vehemently opposed them.

Government tend to set illusive tax-to-GDP targets based on over optimistic projections for tax bases growth and then try to chase these targets through arbitrary measures. These numbers are projected under the pressure of either the IMF program or for the sake of putting up an all good position as well. Once these numbers, which have been floated at budget time, shows sign of plummeting then fiscal policy making gets compromised both for the federal government and federating units who have set up higher expenditure portfolios based on expected increased flow. On the other hand a good tax system need to be least distortionary, has ease of collection, doesn't discriminate and is politically acceptable. Most experts are of the view that Pakistan tax policy is not based on these well-known and clear principles.

These revenue pursuits have faltered the Tax Policy structure. Growth and employment creation is left primarily to some PSDP funded projects and overall tax Policy does not follow principles of fairness, certainty, efficiency and convenience. In general, the current Tax policy is killing transactions which are required for economic growth while pursuing tax targets. This also results in mini budgets and off-budget revenue measures for revenue boasts while chocking the already suffocated business environment and creates uncertainty for new investments.

Therefore we need Tax reforms; where we change the way taxes are collected or managed by the government and is usually undertaken to improve tax administration or to provide economic or social benefits. There have been 16 Tax Reforms efforts since independence. The unmet need for more reforms considering inelastic structure and low tax collection from the economy warrants a critical analysis of history of reforms and there outcome. Revenues thus generated are not upto the mark, required for expenditure needs thus forcing government to borrow perpetually. Which in turn reduces the resource envelop required for development and other critical economic and social needs of the society owing to higher debt servicing costs and debt hangovers. In a more recent work of Nasir et.al. (2020) notes that long term growth and productivity have declined while tax policy has become more contentious and fragmented. Measures multiply as unrealistic targets are chased with mini budgets every quarter. The study further identifies that the policy priority has been to increase tax-to-GDP ratio thus leaving growth and employment to an outcome mainly produced from Public Sector Development Programs (PSDP). Arbitrary and frequent tax changes have created an environment of uncertainty[1].

Considering the importance and strategic nature of the theme Pakistan Institute of Development Economics (PIDE) have been actively engaged in research and provision of evidence based policy recommendations. A recent report titled "Growth Inclusive Tax Policy: A Reform Proposal" by Macroeconomics Section PIDE estimates that there are about 35 out of a total of 82 Withholding taxes, 596 out of total 821 domestic sales tax lines; 42 out of 97 for Sales tax on imports, 37 out of 95 in case of customs and 09 out of 37 in case of Federal Excise Duties, contribute less than 1% in their respective revenue heads. The report further estimates that about 11.14 Billion rupees of compliance cost of these taxes and 0.24 Billion FBR cost of collection is saved if these taxes are not levied. Further if these taxes are not levied, businesses would reinvest them to expand, then the overall impact would be more economic activity resulting in more tax collections. But unfortunately, no one notices the loss to economic growth and job creation due to these adverse tax measures.

Finally, the False Narrative of Tax Cheating nation has to change. Pakistan has served to paint the country as totally immoral as well as with a state that is bordering on failure. This is despite the fact that many of our comparator countries like Bangladesh, Indonesia, Malaysia and others are not doing much better than us. There is a need for Simplicity of Taxes and Better Administration- Not Killing Transactions.

TAX EXEMPTION v/s TAX CREDIT

Tax Exemption: Refers to a complete exemption and/or waiving off of the tax liability on your income. As a result, your income is considered as non-taxable.

Tax Credit: Unlike tax exemption, in case of tax credit, liability is levied on the earner and as a result, the income is considered as taxable. Relief to the earner, however, upon fulfillment of criteria is provided by waiving off payment of the tax liable on the income earner.

Summing up, Tax Exemption reduces the earner's taxable income while Tax Credit reduces the tax payable.

[3] Nasir Muhammad, Naseem Faraz and Saba Anwar (2020), Doing Taxes Better: Simplify, Open and Grow Economy, PIDE Policy Viewpoint 17:2020.

Why People Don't Pay Taxes?

Pervez Tahir

"Taxes have to be collected but what if the collecting organization is inefficient, outdated and corrupt?"

> Even in the case of road tax, while all vehicles pay the same for equal use, some damage the road more than the others. To the extent this happens, the principle of fairness is violated.

In a special televised address urging tax evaders to declare hidden financial assets by the end of this month, Prime Minister Imran Khan observed that Pakistanis were the least tax paying nation of the world. In April 2018, his predecessor, Shahid Khaqan Abbasi introduced his tax amnesty scheme by noting that just 1.2 million Pakistanis filed returns and only 0.7 million actually paid any tax. Similar statements from the high and mighty, tax experts and fiscal analysts can be traced back throughout the seventy-two years of our history.

Let there be no confusion, though. Everyone who makes a purchase in the market has to pay something to the state. This includes the entire population, including children buying toffees. These are the taxes whose burden is shifted to the final consumer; the so-called indirect taxes. Over 60 percent of taxes in Pakistan fall in this category. These taxes are extracted out of the people. There is no possibility to evade if you want to consume or use the stuff you are buying. It can only be avoided by not buying a good or service, something not always possible if life has t in nature, i.e. the withholding taxes. Mobile phone services and cash withdrawals are just two examples.

Does this mean that people only pay when they are forced to? It is said that some 47 percent of the Americans do not pay the Federal Income Tax either. Americans who don't pay are not liable to pay because of incomes below the threshold. This is not the case in Pakistan. There are sectors such as agriculture, and persons and businesses enjoying Statutory Regulatory Order (SROs), that are legally not liable to pay. But the fact remains that millions of individuals and th usands of companies are liable to pay, but do not. For example, the ultimate force in the country, the military, was deployed not too long ago to make traders pay, but without any success. What is the psyche here?

Part of the explanation was implicit in Prime Minister Imran Khan's speech when he described us as a most charitable nation. Though somewhat dated, a study by Arshad Zaman documented it as well. The common experience bears it out. The rising number of beggars at every traffic light, the thriving shrines, and a vibrant non-profit sector providing food, education, health care show it. These are the tasks that the state is supposed to perform.

A not inconsiderable number does not recognise the state. That is what the informal sector is all about. It goes back to the colonial days when the state symbolised foreign occupation. Paying up meant paying for the enemy. Then there are those who recognise the state but think it is un-Islamic. It is better to help the poor and the indigent directly than to pay taxes that might be spent on the undeserving. During General Zia ul Haq's period, the leadership of this group had attempted to replace income tax with Zakat and Ushr. But for an inflexible Ghulam Ishaq Khan, the then finance minister, they would have carried the day. A sizeable segment of the elite thinks that if they have to provide for their own security, quality education, medicare, drinking water and other civic services, why should they pay up.

"I should pay for what I get" has been discussed in the literature as the benefit principle of taxation. In the dharna staged by the PTI in 2014, Imran Khan called for civil disobedience. The public burning of utility bills and the resolve not to pay for the corrupt state was a reference to the benefit principle: the public at large, according to this view, was not receiving the public services that they were entitled to as taxpayers. Mahatma Gandhi and Martin Luther King Jr. had given similar calls in colonial India and the United States, respectively. Originating in an essay by Henry David Thoreau, "Resistance to Civil Government", the civil disobedience was practised by the author who protested against slavery by refusing to pay taxes. In 2012-13, Arvind Kejriwal of the Aam Admi Party in India had led thousands in Delhi to not pay electricity bills.

While it may be justified as a form of political protest, the benefit principle has its limits to form the only basis of taxation. It is true that the purpose of taxing is to finance public services and, in all fairness, those benefitting more should bear proportionate liability. A road tax is a good example. Users pay for use. However, measuring the amount of benefit derived from major public expenditures is not possible. For example, how much does an individual benefit from defence expenditure, policing or debt servicing? Even in the case of road tax, while all vehicles pay the same for equal use, some damage the road more than the others. To the extent this happens, the principle of fairness is violated.

Let's face it. Fair or unfair. Directly beneficial or not. No one likes paying taxes. Individuals and businesses will evade if the incentives are strong enough. Tax avoidance is perfectly legal and the bread and butter of all tax consultants. Taxes have to be collected, if necessary, by force. The problem is with the collecting organisation. It is inefficient, outdated and corrupt. Its contribution to the culture of tax delinquency is by no means small. How to change its own culture will be a major challenge before the newly set up National Development Council. Asked about completing his income tax form, Einstein had said "This is a question too difficult for a mathematician. It should be asked of a philosopher."

Interview

Dr. Hafiz A Pasha

(Professor Emeritus at BNU and Former Federal Minister)

"The fundamental question we face right now is Growth vs Stabilization. This, though also highlights the difference in approach of the two finance ministers, current and outgoing."

"The government has released the position of 9 months fiscal operations, which give us an idea of where we currently stand. The expected reduction in budget deficit is a good sign, but a few problems still exist some of which reminiscent of the previous era.

- The rise in statistical discrepancy to 1% of GDP is worrying and indicates a possible breakdown in the budgeting system.
- There is a big decline in development spending. The spending data is not consistent with the Planning Commission of releases. This shows, that despite releases the development funds were not adequately spent and could be the reason behind increased statistical discrepancy in the fiscal operations. This, however, indicates the lack of capacity in the system to spend the funds appropriately.
- An unusual problem seems to have surfaced, as in attempt to raise the development spending there is a breakdown in the capacity to spend the money at both federal and provincial levels.

A surprising, good news though, is that the provinces currently are flushed with money. Provinces presently have a cash surplus of over PKR 400 billion. This, though, indicates that the provinces are not spending enough, and is a cause of concern. "

"The cabinet has approved the medium-term strategy paper which has then been discussed in the National Assembly committee. This will form the basis of budgetary policies for the next 4 years or so. It is an extremely optimistic medium-term strategy, focusing on high growth with reduced budget deficit. The cabinet through this strategy paper, has approved a tight budget framework. We must be wary of the impact on fiscal space for expansion while aiming to significantly lower budget deficit.

Approving such a framework was necessary in line of IMF guidelines, but if we must grow rapidly as the new finance minister has been stating, we might have to move away from this framework. This could result in suspension of the IMF program, which could also dry up budgetary support from the World Bank and ADB. The finance minister will have to very skillfully plan accordingly to employ expansionary policies while surviving under the IMF conditions while possibly moving on debt repayment obligations 21-22 onwards for 3 years."

"My suggestions to the finance minister and government, if there is scope for renegotiations and changing conditions with the IMF:

Considering the external obligations, Pakistan cannot focus on an unmitigated and uncontrolled rapid short run growth. While a 5-6% consistent growth rate may be achieved down the road, doing so in the short run is highly unlikely. Though some major reforms, as suggested in the PIDE

Reform Agenda may give some hope for a quick high growth.

Be more realistic in budget deficit reduction, while targeting a slightly lower growth in the time being. As per assessment of historical experiences, a modest containment of the budget deficit by reduction of budget deficit equal to 1 percentage point of GDP annually will be a major achievement.

The FBR revenue increase targets should be revised and set around 18-20%, as our highest increase in revenue to date stands at 21%. The 35% increase target as set out by the IMF is on the higher side.

Capacity for development spending shall be increased. Currently, there is a throw forward of around PKR 7.5-8 trillion with 1000 projects under process. Our development spending is under PKR 1 trillion annually. A temporary moratorium shall be imposed on new projects, and focus should be made on full and fast completion of ongoing projects.

Fixed and final taxation has destroyed the progressivity of the tax system. Yearly loss of tax revenue due to concessions and privileges in the law is around PKR 1440 billion. There is enormous scope for progress taxation in Pakistan and must be the focus of future policies.

Currently there are 12 slabs of personal income tax in Pakistan, starting at 600,000 income per annum. The highest slab begins at PKR 75 million per annum with a 35% tax rate. Considering the sufferings of middle class and the rising inflation, my proposal is to reduce the slabs to 5 or 6. The minimum taxable income should be increased to PKR 750,000 per annum, to compensate for the inflation. The highest slab shall begin at PKR 15 million per annum, with a 30% tax rate.
The above two reforms alone can further increase tax revenues by PKR 150 billion without creating any new hurdles for the middle class.

Disagree with the IMF suggestion of withdrawing most of exemptions regarding sales tax. These are reasonable exemptions relating to food and medicines industry. I also disagree with the 2% sales tax on fertilizer, which should be brought down to 0%.

"I disagree with indirect tax strategy of the IMF. Instead, I am in favor of a more progressive move and modest targets to try and achieve stability with some growth."

Interview

Dr. Asad Sayeed

(Associate Fellow at IDEAS)

Dr. Sayeed is also a Senior Research Associate at the Collective for Social Science Research (CSSR), Karachi, Pakistan. He received his MPhil in Economics and his Doctorate degree from the University of Cambridge. He has contributed in the fields of social protection, macroeconomic policy, labor market dynamics in developing countries, and poverty and political economy of corruption.

Q1. Why are NFC Awards important (Given Constitution requires it to be set up every five years), and why have we not been able to act upon the constitutional requirement, why cant we have a permanent secretariat under the CCI?

The NFC is an outcome of Article 160 of the Constitution and is purely related to distribution of revenues across different federating units. The unique feature of the NFC is that it is a consensus based forum. Whenever consensus is not achieved across the federal government and the federating units, there is a deadlock. Prior to the 7 th NFC, deadlocks happened mainly because Punjab would refuse to budge from the single criterion of population in the distribution of resources horizontally. In the 8 th and 9 th Award tenures, the deadlock was because the Federal government wishes to reverse the vertical share of the provincial governments. The 7 th NFC however demonstrated that when all protagonists are flexible and willing to find an acceptable middle ground, a consensus can emerge. NFC does need a secretariat and a research wing. That is something that was on the agenda of the 9 th NFC before the process was stalled. The CCI is a different forum governed by Article 153 and 154 of the Constitution and mandated to resolve a range of other economic and non-economic issues mentioned across the federating units as mentioned in Part II of the Federal Legislative List. . As such, they are entirely different fora.

Q2. PIDE produced a Monograph “The 7th NFC Award: An Evaluation” in which it stressed the need to consider other criteria besides giving major weight to population such as matching grants. Often criteria’s set are considered to be not well researched, do you agree only political consensus is enough?

Other criteria across horizontal distribution were laid on the table in the 9 th NFC and I am sure will be discussed in the 10th NFC also. I am confident that across provinces there is enough flexibility to come to an agreement on adding more than the existing four criteria for horizontal distribution.

On matching grants: This is possible if it pertains to revenues. It is important to remember that the NFC is a revenue sharing forum enshrined in the federal scheme of the constitution. And matching grants on Federal projects is possible but the determination of those projects are approved by the federal legislature. If the provincial government and the provincial legislature agrees, only then can matching grants are possible within the architecture of federalism. But that has nothing to do with the NFC.

On research: The existing four criteria I believe are all fairly well researched. At a broader level, research backup for such fora should be such that research provides different options for a range of possible outcomes that interests of the protagonists and negotiations throw up. There cannot be politically ‘neutral’ research and those who claim as such are actually imposing their own politics through that research.

Q3. 7th NFC award witnesses that all provinces join hands to reduce Federal Share. Do you see any such political consensus or strategic play by federal government or provinces this time.

‘Joined hands’ sounds rather conspiratorial. Given the provincial concerns and pressure on federalism at the time, the provinces and the federal government reached a consensus. If anything, it was the province of Punjab which conceded to a reduction in its share by agreeing on multiple criteria for the horizontal distribution.

Consequent to the 18 th Amendment and the insertion of Article 160 (3A) – which stipulates that the share of the provinces cannot be reduced in subsequent awards – there is no room for strategic play on the part of the Federal Government. A complete consensus against Article 160 (3A) will result in a constitutional amendment but that is beyond the domain of the NFC.

Q4. PIDE had arranged a webinar “10th National Finance Commission Award—Improving Lives of Citizens and Strengthening the Federation" and identified a range of issues pertaining to the design of NFC. Do you think the current formula for distribution of resources among the federating units is sufficient/efficient? Do we need to learn from our neighbors?

Obviously 10 years down the road since the previous award, the current formula needs changes and that is the reason the 10 th NFC is constituted. The provincial governments have expanded a great deal in terms of their jurisdiction and they are as starved for resources as the federal government is. That takes us back to the issue of aggregate resource mobilization in the country and that is something the NFC should and I am sure will deliberate on.

Q5. Can we use CCI as a forum to decide a common goal for each year and allocate (horizontally) the previously reserved ‘Also decide about emerging needs on yearly basis such as One percent share of KPK (for war against terror), Covid-19 for this year, FATA merger or alike.

I have discussed the different constitutional domains of the NFC and CCI earlier. ‘Common goals’ in terms of economic allocations are decided upon by the National Economic Council (Article 156 of the Constitution). The NEC forum has been the most moribund and needs to be activated for the purpose it was instituted for. It is again different from the NFC. I personally think it is best to keep focus and let different constitutional fora perform their own functions.

Within the NFC we can come up with dynamic and time-bound criteria that address revenue-distribution based on principles of fiscal equalization, such as the FATA merger or the KPK share for war against terror and other contingencies.

Need-based’ NFC allocation should be accommodated for incentive-based resource allocation.
Incentive based so far as revenues are concerned. We already have one criterion – 5% weight for revenue generation – in the horizontal distribution. There are other proposals that have been put forth and we hope to discuss them in the course of deliberations.

Earmarking allocations such as annual social-protection budget of a provincial government should be in accordance with divisible pool based on poverty and backwardness indicators.
Am not clear as to what you are asking here. Earmarking allocations for social protection or for that matter any other area is the sole prerogative of the provincial legislature. Sharing of divisible pool resources through the NFC is an element of fiscal federalism, which in turn is a constitutional right.

Pervez Tahir

Agriculture Tax: Route To Evasion In Non-Agri Income

IN the seventh NFC award, the federal government was asked to raise the tax-to-GDP ratio to 15 per cent and the provinces were expected to effectively tax agricultural incomes. This would have enlarged the divisible pie and the provincial kitty. While the centre failed to reform the tax structure, the provincial governments paid no attention to mopping up the potential of agricultural incomes. The eighth NFC failed to give an award, leaving these issues — and more — to the ninth NFC.

The Constitution limits income tax to non-agricultural incomes, a federal subject. Agricultural income falls in the provincial domain and is subjected effectively to a tax on land. This distinction is unfair as it violates the principle of taxing equal incomes equally (the so-called horizontal equity). It is also against the principle of ability to pay, as a large number of earners are not taxed at all (the so-called vertical equity).

Worse, it provides a convenient route to non-agricultural income earners to evade federal income tax by declaring vast amounts as agricultural income. All the provinces together do not collect more than Rs2 billion. According to the latest annual report of the State Bank, this is 0.03pc of the agricultural GDP.

Here's the rub. Dominated by the large landholders, the provincial governments do not make the required effort to collect what is due under the existing tax laws. The attitude goes back to colonial times. With a view to creating and protecting the loyalty of feudals, the agriculturist/non-agriculturist distinction was encouraged not only in incomes, but also with regard to jobs and admissions to educational institutions.

When first introduced in 1860, income tax included income from agriculture in the definition of income. Writing in 1920, Shankar Madhav Pagar observed:

“For the first time in the history of the world it was demonstrated that India, an oriental country was ready to meet with equanimity and courage the greatest engine of Western finance — a modern income tax.”

By 1886, agricultural income had been exempted, as the landed class termed it a violation of the Permanent Settlement agreement. Today’s argument, that agriculture is already overtaxed, also goes back to those days. The exemption continued after Independence. In 1977, Zulfikar Ali Bhutto’s attempt to levy a presumptive agricultural income tax in place of land revenue was aborted by Gen Zia to appease the feudal lords.

Land reform was also declared un-Islamic. This opposition continues, although agriculture’s share in total tax collection is a measly 0.6pc against its share of 19.2pc in GDP. The low share is the result of the elimination of taxation implicit in support prices and exchange rate, besides negligible explicit taxation. To confuse the issue, this is the argument sold by the large farmers to small farmers. Even today, there is little awareness among the small farmers that a vast majority of them will be exempted under any income tax formula.

The ninth NFC presents an opportunity to finally end the distinction between agricultural and non-agricultural incomes. Neither the PPP nor the PML-N had any interest in alienating the feudal support. The MQM represents middle-class opportunism more than the middle class. In 2011, one of its senators moved a private bill to include agricultural income in the definition of income. Despite being in the government, the move was to support the opposition, the PML-N, to thwart the imposition of the ‘anti-urban’ value-added tax.

For the first time, a nationwide party claiming the support of the middle class is in the saddle at the federal level and in three provinces. It has its share of landlords.

That is perhaps why the party manifesto is silent on the issue of agricultural income tax. But the party also has Jahangir Tareen, who has said many a time that he had to make special efforts to pay his due against whatever exists in the name of agricultural income tax. The authorities did not seem keen to collect it, as it would set a ‘bad’ precedent for the powerful farm lobby.

Be that as it may, championing a *“shift towards direct taxation as the primary source of tax revenue”* is the broader objective of the PTI manifesto. Effective taxation of agricultural income will further this objective.

Of course, this requires a constitutional amendment. Careful negotiations and a credible estimate of gains can make it happen. Back-of-the-envelope calculations place the yield between Rs150 billion to Rs200bn. The yield from plugging a hole for evasion will be in addition. All parties in the NFC will gain, in proportion to their respective shares in the divisible pool, without touching the sensitive vertical distribution.

Huzaima Bukhari

Tax Cheating?

> "The reward for saving money is being able to pay our taxes without borrowing."

How many of us set apart some of our earnings for the purpose of fulfilling our tax obligations? We may save for the rainy day but we hardly ever hear of anyone saving to pay the tax authorities! This is the reason why there is such a thing as 'withholding tax.' The public in general, considers "withholding tax" as parallel or akin to income tax but something, which is not actually income tax. The fact is that withholding tax at source or collecting tax beforehand is merely a form whereby income tax is bit by bit, taken from the taxpayers.

The only thing good about those withholding taxes is that a fellow doesn't get so mad all at once.

In other words, the concept is that of 'pay as you earn' (PAYE) or 'pay as you spend' (PAYS). This way one does not have to produce a hefty sum at the time of filing one's annual tax return. It solves the problem for all those people who are unable to manage their funds diligently thus ending up with no liquidity for discharging actual tax obligation when filing return. This clearly indicates that the aim of withholding is to facilitate taxpayers rather than putting them in a complicated maze of keeping track of innumerable deductions/collections and their consequential implications vis-à-vis their actual tax liability.

The best tax law is the one that gets the most feathers with the least squawking.

This is where the quandary lies. What was introduced as a matter of convenience for taxpayers became an obsession with the tax authorities resulting in approximately 60 different provisions related to collection/deduction of income tax. Interestingly, these are mostly transaction or consumption based which means that not only do people pay tax on their actual income but the same tax-paid-income is again subjected to tax when they spend, say on buying a new car or paying their children's fees. So what started off as a transitional form of taxation for achieving the objective of formalization of economy has become a permanent legal fixture defying the entire philosophy of direct taxation.

One can be born free and then be taxed to death.

What makes this even more painful is the ensuing legal complications with respect to such advance taxes that are forcefully extracted from even those who are neither liable to file return of income nor obliged to pay any income tax. These taxes could be adjustable, full and final or even minimum in nature, but how is the common man to know which is which? After all, how many are aware about their duties towards the State regarding payment of taxes and how many can actually afford the services of a professional tax consultant? How much has the government actually invested in educating the taxpayer other than terrifying them with dire consequences?

What's the definition of an accountant? Someone who solves a financial problem you didn't know you had in a way you don't understand.

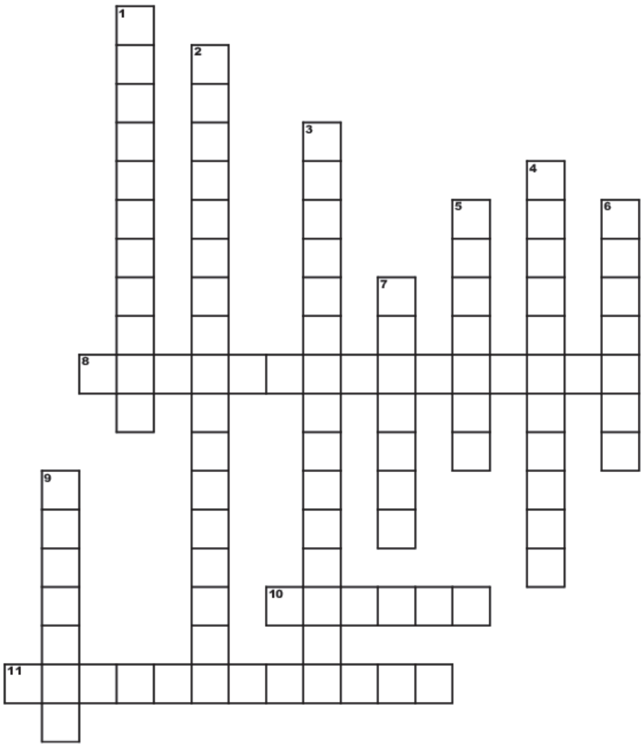
The fact is that why should those, who are not legally liable, be compelled to file returns only to take back what was extorted from them in the garb of withholding taxes? There are millions out there comprising labourers and those belonging to the lower trading class who have no clue that the government has robbed them of both their hard-earned money as well as their fundamental rights given to them by the constitution of this country. They are not educated enough to realize this but are made to bear the guilt of being proclaimed tax cheats by none other than those public functionaries who have swindled them in broad daylight in the name of law. While the so-called intelligentsia, the courts and the bar keep mum about the existing injustice, the poor and helpless are left with no option but to accept without any question whatever ordeal they are made to endure.

The reality is that almost 100 million unique mobile [total subscribers as on 31 August 2020 were 169 million as per data[2] available on website of Pakistan Telecommunication Authority, but many have more than one SIMs and some are dormant] users alone pay advance income tax despite the fact that majority of them is not enjoying taxable income. Law does not require them to file returns but they are dubbed as non-filers after tax is extorted from them in the name of advance income tax. Income tax is extracted from traders through electricity bills on the commercial meters installed at their business premises. Many may not even notice that they pay their tax when making payment of the bill. This constitutes minimum tax liability for those whose total electricity expense for the year is up to Rs. 360,000 and innumerable small traders, even those located in rural areas fall in this category. The issue is that the amount of tax taken in this manner might not be the actual tax liability in the case of such traders who are barely able to eke out a living. If their income falls below taxable limit, they are not entitled to any refund whatsoever. People cannot be deprived of money/property that they do not owe to the State yet they are accused of being tax cheats.

The general impression about tax functionaries is that they are highly corrupt, antagonistic and intimidating. As a result, the common perception is that it is better to stay away from the tax administration which is why people are willing to sacrifice their money for the sake of remaining hidden from the voracious eyes of the taxman. The common man claims that the government has failed to nab the rich and mighty who actually evade taxes, get billions of rupees worth loans written off, transfer heavy funds to off-shore accounts and the cherry on top is in the form of amnesties enjoyed on regular basis. What was the fate of nearly 3 million rich people about which an ex-Chairman of FBR claimed he had solid information about lavish living? Not a single evader has ever been prosecuted. In this situation all they can find are the poor and weak to milk dry cows, especially when they are deprived of universal entitlements.

The same is true for the tax advisors who are ready to fleece their client before being ripped apart by the revenue authorities. If these are the prevalent conditions then how can there be established a relationship of confidence between the government and the public? In the absence of this trust there is no way that the people will comply with their obligations openly. They will, however, continue to tolerate atrocities silently and be labeled as cheats. It is about time that we review our attitude, laws and procedure before hurling such allegations on the public.

Budgeting and saving



Across

8. Money received from gifts, odd jobs, and so on
10. Money received
11. An unchanging expenditure

Down

1. An amount of money spent
2. An unforeseen cost.
3. An expenditure that varies
4. Money received after all adjustments and deductions are made
5. Money that is not spent
6. An itemized summary of probable expenditures and income for a given period
7. The amount of money remaining after all expenses have been met
9. The amount by which expenditures exceed income.

Word Bank

fixed expense	**surplus**	**expenditure**	**irregular income**
savings	**flexible expense**	**income**	**deficit**
unexpected expense	**budget:**	**take-home pay**	

[2] *https://www.pta.gov.pk/en/telecom-indicators.* Details show that out of total 167 million subscribers, 85 million are 3G/4G subscribers, 3 million basic telephony subscribers and 87 million broadband subscribers.

Respect To Taxpayers

Dr. Ikramul Haq

Revenuecracy[4] keeps on maligning the citizens as tax dodgers. Unfortunately, the bandwagon is joined by the so-called “informed” analysts and all-knowing (sic) TV anchors calling Pakistanis “tax cheat”, whereas reality is quite the opposite. The often-repeated popular jargon that only “1% of the population pays income tax” has become Gospel’s truth in Pakistan that nobody is ready to disbelieve. It exposes the hollowness of all those who subscribe to it. Collection under withholding income tax regime was Rs. 1091.5 billion out of total direct tax collection of Rs. 1513.8 billion in fiscal year 2019-20, according to official source, ***FBR Year Book 2019-20***[5]. Advance tax paid was Rs. 351 billion and with returns Rs. 61 billion. FBR collected only Rs. 61 billion (arrears of Rs. 14 billion and out of current demand Rs. 47 billion) with its own efforts, which is only 4% of total collection.

> One slogan that is not raised enough by the economic or political agents in the country is *'taxpayers ko izzat do'*. The matter cannot be overemphasized—Ali Khizar, **Respect the taxpayers**[3], *Business Recorder, November 1, 2020.*

The argument that the staff of Inland Revenue Service (IRS) contributes by monitoring of withholding taxes is fallacious as bifurcation of major contributors under withholding income tax regime shows: **Contracts (Rs. 237.4), Imports (Rs 199.6 billion), Salaries (Rs. 129.4 billion), Bank interest & securities (Rs. 128.1 billion), Dividend (Rs. 55 billion), Telephone (Rs 54.6**

billion), Electricity (Rs. 45.4 billion), Technical Fee (40.1 billion), Exports (Rs. 38.4 billion) and Cash withdrawal (Rs. 15.1 billion)—Table 10, Page 15 of ***Year Book for 2019-20***[6]. It is pertinent to mention that no bifurcation is given for remaining 56 withholding tax provisions prevalent during the relevant year. Federal Board of Revenue (FBR) claims that withholding taxes need strict monitoring for which it made "extraordinary" efforts. If this is true then defaulting withholding tax agents must have been penalised and its demand should have reflected in either current/arrears collection, or through a separate note, which is totally missing. It is still open for FBR to post on its website the details of any such actions as well as make public, the number of income tax returns and sales tax registered persons, category wise, as on June 30, 2020. It must also disclose the quantum of due refunds as in the Year Book for 2019-20 only refunds actually paid are mentioned.

It is admitted by FBR before the Standing Committee on Revenue of National Assembly that total refunds due on June 30, 2020 was of Rs. 710 billion 7 . If the admitted refunds payable are deducted from the total tax collection of FBR for fiscal year 2019-20, the net figure comes to merely Rs. 3287 billion or just 7.7% of GDP. Millions pay advance income tax despite the fact that majority of them has no income or income below taxable limit. Law does not require them to file returns but under the lenders' agenda to retard growth and in the name of so-called documentation drive, FBR wants to harass them. The members of Parliament passed tax laws as suggested by Executive without proper public debate and its critical review by independent professionals. The Parliaments and judiciary have failed to protect the fundamental rights of citizens. Forcing a person not earning taxable income to pay advance tax or file tax returns is a blatant violation of Article 4(c) of the Constitution that **"no person shall be compelled to do that which the law does not required him to do"**.

Another wrong notion is that traders and manufacturers do not pay income tax. All of them have been paying advance income and sales tax with electricity bills. Section 235(4)(a) of the Income Tax Ordinance, 2001 says that in the case of a taxpayer other than a company, tax collected up to Rs. 43,200 of a commercial electricity user shall be treated as minimum tax and no refund shall be allowed even in cases suffering losses, especially in the wake of Covid-19 endemic/lockdowns. Law recognises payers of advance income tax with electricity bills as "taxpayers", yet FBR and their bandwagoners call them tax chor (tax thieves) **"defaulters" and "evaders" and State thieves are given tax exemptions, concessions, waivers and amnesties.**

Majority of the mobile users who pay advance/adjustable tax having no taxable income are supposed to file complicated income tax return and wealth statement electronically to claim refunds. About 65% of our population being young and yet not employed is not chargeable to tax. FBR is extorting income tax from 100 million unique mobile users (having more than one number and active users). According to Pakistan Telecommunication Authority (PTA), the total number of cellular subscribers as on March 31, 2021 was 183 million (84.68% teledensity), out of which 98 million are 3G/4G subscribers (43.51% penetration), 2 million basic telephony users (1.13 teledensity) and 101 million broadband subscribers (46.4% penetration). At present, the entire taxable population and even those having no income or income below taxable limit are paying income tax at source as mobile users, yet FBR is engaged in a vicious propaganda that people of Pakistan are tax cheats. **This is highly lamentable, especially when 4 million commercial/ industrial electricity users are paying advance income tax and sales tax with electricity bills.**

For elimination of trust deficit between tax collectors and taxpayers, the following ten steps are inevitable:

- The tax laws/rules/procedures in existence need to be simple, fair, reasonable and easy to comply.
- In the administration of tax laws, sense of justice needs to be ensured/enhanced.
- The goal should not be meeting targets, but collecting the right amount in accordance with law.
- Existing tax laws are complicated and ambiguous. These are difficult to understand and vulnerable to diverse interpretations, leading to undue litigation. These must be replaced with simple and enforceable codes.

- Lack of accountability has taken away the sense of justice from tax administration and people have to deal with multiple tax agencies. Corrective measures are required to merge various tax agencies and regain the confidence of taxpayers.

- Tax collection must be used productively, without wastage.

- Maximum tax rate should not be more than 10% for individuals and 20 percent for companies.

- State providesthey are unable to earn. They have nothing to fall back on. Government is a partner only in income not otherwise. **Reciprocity of taxes needs to be provided**.

- A high tax paying person is disillusioned when the dishonest are offered amnesties/ waivers frequently. Squeezing tax from the honest and rewarding the delinquents dissuade others to make true compliance, especially when the influential enjoy tax-free perquisites and benefits, palatial bungalows, army of servants, free foreign trips, medical facilities abroad, free facilities of clubs, plots etc.

- Tax administration should treat taxpayers as respectable citizens and not as “tax evaders”.

[3] https://www.brecorder.com/news/40029869. The punch line of his op-ed is: “The perceived cost of documentation for many is too high. That is why neither higher interest rates nor higher taxes on non-filers are working. The culture of tax collecting agencies (especially FBR) must change. The trust deficit between the government and taxpayer must also be reduced. For that overall public service delivery (governance) and FBR's way of operation has to improve. All easier said than done though”.

[4] Term used by Dr. Pervez Tahir (Giving FBR a decent burial, The Express Tribune, November 8, 2019).

[5] http://download1.fbr.gov.pk/Docs/2020929129450205FBRREVENUEDIVISIONYEARBOOK2019-20.pdf

[6] Ibid

[7] https://tribune.com.pk/story/2262228/tax-refund-claims-balloon-to-rs710b

Saba Anwar

Historical Trends in Expenditure

“The purpose of the government is to enable the people of the nation to live in safety and happiness. Government exists for the interests of governed, not for the governors." - Thomas Jefferson

The idea of democracy and a resultant welfare state with inclusive growth has been romanticized in Pakistan for a very long time. The proponents of welfare state have been highlighting the role of government to stimulate a level playing field between have and have nots. Yet somewhere in the entire process of ensuring interests of the governed, a lot of expenditures incurred are found to be not meant for the governed at all. Let’s take a deeper look into the patterns of expenditures and also the efforts to curb unnecessary expenditures in the face of huge fiscal deficit – a permanent feature of Pakistan’s economy.

The fiscal deficit in 2019 increased to 9.1 % owing to unprecedented fall in tax revenues and sharp rise in current expenditures. This rise in current expenditures kept total expenditures at a higher level. Higher interest payments, untargeted subsidies and loss making SOE’s remain the major challenges to the fiscal discipline along with covid 19. The current expenditure contributed around 85.1 % in total expenditure. The rise in domestic interest rate increased the share of markup payments to 29.4 % in 2019. The defense related expenditure increased to 16.1 %. The higher energy related subsidies due to power generation led to a significant increase in subsidy share of current expenditure. The subsidies registered a growth of 75 % in July-March 2020. The inter –Disco tariff differential (133.9 billion), WAPDA (8.5 billion) for receivables from FATA and additional 10 billion subsidy to Utility Stores Corporation (USC) led to the rise. The grants increased by more than 50 % as compared to the previous year. The other components of current expenditures includes:

superannuation allowances and pensions, grants (other than provinces), other general public services, public order and safety affairs, economic affairs and social protection. At provincial level the increase in non-tax revenue was observed in profits from hydroelectricity and irrigation. In FY 2018, the total and current expenditures were higher than the last five-year average. The growth in total expenditures decelerated to 10.1 % as compared to growth of 17.3 % in FY 2017. The major reasons behind slow growth were reduction in development expenditures and net lending. The current expenditure increased because of increase in provincial current expenditures. The share of current expenditures in total expenditure increased from 76.4 % in FY 2018 to 78.2 %. The share of provincial current spending was recorded at 19.6 % which led to primary deficit. The share of defense expenditure, mark up payments and current subsidies in current and total expenditure did not register any significant variations.

In FY 2017 the fiscal deficit increased to 5.8 % of GDP primarily due to low provincial surplus, short fall in revenue collection and increased in project loans on account of CPEC related activities. The total expenditure stood at 21.3 % of GDP as compared to 19.9 % in FY 2016. The major factor was the development expenditure that recorded the growth of 30.1 %. The fiscal deficit of provinces because of increased expenditures and low revenue collection. There are expectations of further increase in development expenditure in the next fiscal year.

A significant reduction was observed in primary deficit in FY 2016. The current expenditure maintained the same share in GDP as in FY2015 with a slight increase in the share of development expenditures. The significant fall in the markup payments and subsidies reduced the growth of current expenditure. There was a substantial decline in power subsidies owing to improved performance of DISCOs, rationalizing tariffs, reducing delays in tariff determination. The provinces showed better fiscal discipline resulting from controlled current expenditures and higher revenues collection. A sharp decline in non-tax revenue was observed due to decline in surplus profit of SBP and decline in receipts under CSF.

1.1 PSDP

The July-March 2020 witnessed a sharp increase in development expenditure both at the federal and provincial level. The provincial PSDP increased remarkably and grew by 38.4 %. A significant part of this was allocated to agriculture and food, transport and construction.

There was a sharp decline in PSDP spending both at the federal and provincial level in 2019. Thus development expenditure declined in 2019. The net lending also followed development expenditure.

The PSDP spending remained low at the end of FY2018, as directed by the Election Commission which prohibited initiating any new development project. The PSDP thus reported a negative growth of 7.7 % as compared to growth of 33.1 % in FY2017. Noteworthy is the difference between provincial and federal PSDP expenditures. The federal PSDP showed a negative growth of 20.6 % while the provincial PSDP registered a growth of 3.3 %.

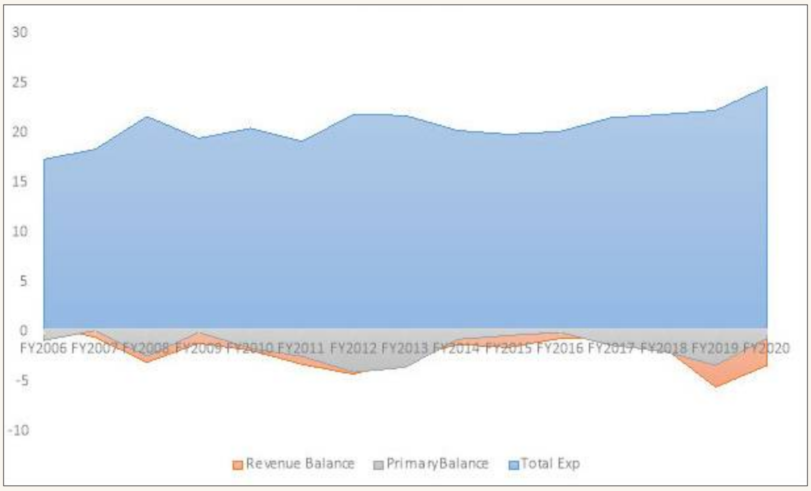
The size of federal PSDP increased during FY 2017.

1.2 Social protection

The development expenditure for BISP reported a significant growth of 53.7 % in FY 2018 as compared to FY 2014.

The allocation under BISP increased substantially and reached 121 billion in FY 2018.

The allocation to BISP increased in FY 2017.



Graph 1: Trends in Components of Expenditure (as % of GDP)

2 Measures taken to curb Expenditure

In year 2020, the binate challenge of increasing expenditure on health and social protection and mitigating the impact of COVID 19 impact on economy has brought fiscal accounts under immense pressure. On the fiscal side, a comprehensive fiscal stimulus package was introduced. In order to meet the financing requirement for these expenditures, additional resources have also been mobilized through various international financial institutions including IMF, World Bank, ADB etc.

The fiscal deficit in FY 2019 was the highest during the last five years. In its attempt to manage public expenditure more efficiently, the government strived to achieve a legal framework in which public spending units can acquire greater autonomy but with greater accountability. The absence of legal provision was identified as one of the major barriers to address the paramount challenge of improvement in governance and public service delivery. The reforms, named as Public Financial Management Reforms (PFMR), were aimed at achieving a better coordination between federal and provinces to rule out the overlapping expenditures and leakages from the system. The public sector enterprises were expected to increase efficiency and be self-reliant.

- The Program for Result (P4R) modality, one of the initiatives of PFMR, was implemented by ministry of finance with the support from world bank. The main objective of the program is to improve the system to ensure efficient management of public finances.

- The assignment account procedures were revised and new procedures were laid out. The assignment account rule was extended on current budget allocations to cater the needs of autonomous bodies. These accounts were prohibited for ministries, division, departments, sub ordinate offices, projects and organizations where there is only government funding. The principal accounting officer were asked to maintain an internal audit cell to improve internal controls. No cheques can be drawn in the name of project authorities for the transfer of funds from consolidated funds to commercial bank accounts. The practice of allocating one line budgets was discontinued. The sub assignment account was introduced. Constituted under the main assignment account, the sub assignment transactions are reflected in the main account ensuring transparency. the ministries and divisions can achieve additional budget through supplementary grant only through approval formal approval of cabinet.

In FY 2018, the efforts directed towards the introduction of wide ranging reforms in the area of fiscal management. This included the power sector reforms and the restructuring of Public Sector Enterprises (PSEs). The objective is to reduce the unproductive expenditures and create fiscal space for social safety nets and growth oriented projects. In the last five years the total development expenditures have increased from 3.5 to 5.3 % of GDP in FY 2017. The monitoring of expenditures was emphasized to avoid un budgeted expenditure and to ensure that expenditures are made in the light of flow of receipts. A ban was placed on purchase of all types of vehicles both form current and development expenditures except for operational vehicles of law enforcing agencies.

The FY 2017 marked the execution of wide ranging restructuring reforms in the power sector and the PSEs.

- **Power Sector Reforms**

Under the framework of National Power Policy 2013, major governance reforms were introduced in the power sector. The subsidies to the power sector were significantly reduced. A Circular Debt Capping Plan was finalized to manage the power sector's financial flows, subsidies and stock. To avoid the accumulation of new arrears, the reforms focused on improving DISCOs performance, rationalizing tariffs and reducing delays in tariff determination. The prudent overhauling of the financial and management system of GENCOs and DISCOs was approved to make the sector sustainable. In addition to these governance reforms, the efforts were made for the right fuel mix in the power sector.

- **PSEs Reforms**

The pillars of revival of public sector organizations reforms program included divestment through strategic partnership and public offerings, ensuring enforcement of public governance laws and restructuring plans and regulations. The diversity in the nature of PSEs led to multifaceted reforms with common objective. The divestment in banking sector resumed. Pakistan Railways was cited as a success story that reported higher revenues in FY 2014, 2015 and 2016 after the implementation of revitalization program. The revitalization program included rationalization of tariffs, expenditure controls and improved occupancy rates. PIA was converted in a company PIAC under the company ordinance to run PIA with an up to date legal system.

Box 2: Impact of Public Investment on Growth: Evidence from Recent Research

Papers	Result
Bint-e-Aijaz, Maryam and Nazima Ellahi (2012)[5] Ghani, Ejaz and Musleh-ud-Din (2006)[6]	Negative impact on the growth rate, mainly investing in the sectors, which are unproductive and inefficient. Public investment has a negative, but insignificant, impact on growth.
Khan, M. Tariq Yousuf and Komei Sasaki. (2001)[7]	Sufficiently large during the early period but decreases over time.
Elahi, Nazima and Adiqa Kiani (2011)[8]	Role of public investment is negligible due to its inefficiency.
Saghir, Rabia and Azra Khan (2012)[9]	Government development expenditures have an insignificant impact on growth.

The main heads of expenditure remain unchanged leaving government in dire need of fiscal space only to increase the development expenditures. A clear look at the expenditures reveal that the government in the 21st still aims at building the infrastructure. This approach is clearly the outcome of HAQ/HAG model which Pakistan has been pursuing for the past sixty years Haq et al, (2020). The study shows that mere focus on physical infrastructure through discrete projects or "brick and mortar" development has fizzled the true essence of development in Pakistan. Various econometric studies as reported in box 1, also support the Haq et al (2020). The studies show that public investment does not drive either economic growth or private investment. A closer look into the political economy of planning shows that these findings are not surprising. These projects are creating only assets that are more expensive than they should be and the returns are seldom maximized. Why this is happening? The answer lies in the fact that these projects are approved on the basis of political imperatives rather than Cost-Benefit Analysis. The HAQ/HAG model emphasized on expenditures even if they were carried out with foreign aid, without analyzing the outcome of inputs. The sectoral share of PSDP shows that we have yet to deviate from the brick and mortar strategy and spend for the governed.

PSDP: Challenges and Reforms

Muhammad Shaaf Najeeb

HAQ/HAG APPROACH TO DEVELOPMENT

Haq/HAG development approach was influenced by the Harrod-DOmar and 2 gap model. It was then implemented in Pakistan by Dr. Mehboob Ul Haque and the Harvard Advisory Group, and hence has been referred to as the Haq/HAG approach. The key features of the approach suggested focus on following:

Building physical infrastructure through discrete projects of sectors in the economy.
Developing medium term budget for financing sectoral hardware.
Financing budgetary gaps through foreign aid.

The approach was adopted at a time of extreme infrastructure shortage globally while the concept of globalization was still unknown. It naturally focused on “brick and mortar” as well as searching for aid. In addition, it merely looks at expenditures and not results, as developing the hardware of economy was important to kick-start any development and growth at that time.

Policies and viewpoints come about influenced by the situations and time they are conceived in, and this is why policies and viewpoints are subject to constant evolutions and upgradations. Evolution and upgradation though, have been completely strange concepts to Pakistan’s policymaking when it comes to PSDP.

Pakistan modelled its development policy around the development philosophy of the Haq/HAG Model. While this approach proved beneficial in initial times in developing countries, including Pakistan, but over time this has resulted in an excessive focus on brick and mortar infrastructural development while the software of economy continued suffering. In order to support this infrastructure led development, the institutions have repeatedly been weakened and their role in policymaking reduced. One example is the Planning Commission which has been reduced to just a PSDP approval body, with minimal to no planning responsibility in this regards left to it.

The Planning Commission notes PSDP as an important policy tool for creating spillover impact in the economy for private sector and leveraging economic potential for the overall greater social good of the country. PIDE's research, as mentioned in its Policy Viewpoints 1 on the matter, paint a completely different picture backed by econometric research. Evidence suggests that public investment has failed to act as a driver of economic growth or private investment, despite continuous and persistent attempts by the government to use public investment through PSDP as the instrument that generates and drives economic growth and private sector's development. This has severely dented PSDP's effectiveness, and as the allocations continue becoming more and more political than developmental, the effectiveness and efficiency continue falling down.

Worldwide, in developing countries as well as the now developed countries, the Haq/HAG model has been left behind as they have managed to successfully break through the glass ceiling of underdevelopment and sustained their rapid economic growth. This was possible because these countries focused along with developing their infrastructure, on increasing their human capital. While working on investing on their human development, these countries have also opened up to the world primarily through trade and cashed upon the benefits of globalization, a concept unknown at the time Haq/HAG model was prescribed.

Additionally, these countries have managed to reduce the government footprint in their economy and let the private sector take the lead while acting itself only as a facilitator. This has resulted in greater research, development and innovation which have driven their social and economic growth. On the contrary, Pakistan is still stuck behind the brick and mortar and caught in the low growth trap. It is about time that Pakistan shifts its attention from the Haq/HAG model and refocuses the PSDP to a more Result Based Management System. Only then, in today's world, can we be able to compete with the outer world and restart our journey towards accelerated growth.

RESULT BASED MANAGEMENT (RBM)

RBM as the name suggests, refers to a system where projects are prioritized based upon their benefits to the economic growth of the country. This involves a complete overhaul of the PSDP approval and budgetary allocation process, as it requires much greater monitoring and evaluation from the recommendation to approval stage followed by performance monitoring of each project.

The rationale behind RBM is to invest in projects that have a higher social and if possible, financial return so that maximum benefit can be extended to the general public as well as the overall structure of the economy. Shifting to RBM will also help reduce the politicization of PSDP while the increased coordination among the state institutions and departments will help ensure that the projects are timely completed and effective in driving the growth of economy as well as private investment. This change in PSDP process can help reduce government footprint from the economy while encouraging and facilitating the private sector to take the lead in research, development and innovation.

PSDP: A Political Phenomenon

Muhammad Shaaf Najeeb

"The Public Sector Development Programme (PSDP) is an important policy instrument for achieving socio-economic objectives of the government. It also creates spillover impact for the private sector and leverages potential of the economy for creation of greater social good."

These are the first lines of the Planning Commissions' 2020-21 PSDP document, and although they paint a wonderful picture of the PSDP; we really must consider if it is even in sight of the reality, let alone close to it. Since the 18 th amendment, PSDP has seen a significant change as the provincial share in the development outlay has increased while functional responsibilities have also been distributed among the three tiers of government i.e. federal, provincial and local governments.

The Planning Commission's role over the years has more or less been limited to being just a PSDP approving body, with much less planning coming through the commission. Although PSDP is announced annually in the budget before the start of the new fiscal year, the process of finalizing begins much earlier. Each Ministry or Division forwards its projects and required funds estimate for approval to the Planning Commission. As a result, series of discussions, evaluations, and valuations are carried out over the next few months before the Planning Commission finally approves the PSDP funds for the coming fiscal year which then becomes part of the budget document presented to the cabinet for approval before being tabled in the parliament.

While some would see it as a positive devolution of responsibility and empowering the ministries and divisions, however, it comes with issues attached. As a result of this devolution, there is a lack of central planning or policy being followed through the PSDP projects as the project preferences relating to the said ministry are ranked as per the ministry's evaluation instead of the government policy and mandate upon which they have been voted to power by the people. Secondly, it also increases the chances of the minister's bias being represented in the PSDP project recommendations forwarded by the ministry, while also opening gateways for rent-seeking pressure groups to influence the decision of ministries. Not only this, but there comes a great degree of policy inconsistency as well due to the change of ministers' portfolios as every minister could bring their preferences and policies under the ministry.

The Planning Commission's role has thus been limited to just a PSDP approving body, which gets to pick and choose only from the recommendations made by the ministries, instead of being responsible for formulating short-term and long-term policy objectives and then devising a PSDP program that revolves around those policy objectives. This has resulted in PSDP allocations becoming a major political gimmick and selling points as well. Political parties and candidates individually use PSDP allocations during their governmental or ministerial tenure as a major campaigning point for the elections. This attitude is reflected in PSDP allocation decision-making as well, as large amounts of money are allocated for projects that do not seem necessary or fruitful but help the government party and members gain political mileage and support. It would not be wrong to say that **PSDP is turning into a 'Political Support Development Programme' instead of being a Public Support Development Programme**.

Ideally, such a development programme in a country like Pakistan must be investment driven. This means, that the PSDP should focus more on projects that help generate revenue by initiating and encouraging economic activity in the economy. This will result in increased employment and wealth creation in the economy. The government's lack of focus on acting as a facilitator and encouraged through the PSDP for developing an investment-driven development model, as has been done by China, has resulted in increasing the inefficiencies attached with the PSDP allocations. At this moment, while there are few investment-driven projects part of the PSDP, numerous entirely demand-driven projects are also part of the PSDP for years. The demand-driven nature and political leverages now attached with a higher PSDP allocation have increased the PSDP throw-forward liabilities to around PKR 6 Trillion. This is a testament to the notion that PSDP projects are becoming a burden on the already thin fiscal powers of the government due to increasing inefficiencies and lack of revenue generation from these. It is of utmost necessity that the Planning Commission is made responsible for long- and short-term planning with regards to the PSDP and allocations are more investment-centric to be able to generate revenue for these projects and those in the future. This will eventually help restrict the throw-forward liabilities from increasing while also proving to be a facilitator in increasing economic activity and thus wealth creation in the economy.

THROW-FORWARD

Numerous PSDP projects are approved and initiated without any proper financing plan or availability of required funds. Despite allocation, government is unable to provide adequate financial support to these projects timely which not only builds the throw-forward but also causes delay in the projects. Multiple delays also often result in increasing the total cost of project, which eventually has an impact on the throw-forward as well and by the time these projects are completed, their cost turns out to be much higher than initially estimated. The ahead graph represents the amount of throw-forward over the past few years in PSDP.

Flattening the Government Pensions Curve; Making them Sustainable

Mahmood Khalid & Naseem Faraz

Prime Minister Imran Khan while chairing a cabinet meeting on August 28 th , 2020 has said that the burden of pensions was fast becoming unsustainable and directed Finance Ministry to include eminent international experts in the Pay and Pension Committee to professionally evaluate the best available options[8].

Most of the countries around the world have pension systems which are intended to provide income support to those persons who have either lost earnings due to old age or become disabled due to some incident. Each pension scheme must result into adequate resource provision to meet the basic living standards and decreases difference in pre and post retirement earnings. This would help pensioners live a decent standard life post retirement as ability to earn reduces post superannuation. Funding these pension schemes can be through either forced savings or contribution by employers (including governments). Some argue it's the sole responsibility of the individual vis voluntary savings or the family vis family contributions or the State. However on thing is certain that changing demographics in terms of an ageing = population, weaker family support, increase health services and higher expected lives have created need for policy response to be dynamic.

PIDE Policy Viewpoint No 22.2020 ***"The Pension Bomb and Possible Solutions"*** critically evaluated the government existing Pension system for Pakistan and proposed some out of the box solutions to manage this crisis. Unlike other countries Pakistan has not reformed its public sector pension system and maintains a pay-as-u–go defined benefits type pension system, which has resulted in increase in unfunded liability for the government. Pakistan practices a legacy pension system where pensioners are paid directly from the revenues as part of the current expenditures. Government Pension expenditures are growing at around 25%, which cannot be provided from an economy growing at a much lower rate. The pension burden is therefore bound to grow, rather doubling every four-years. In the fiscal year 2018-19 federal superannuation and pension expenditures were almost 78% of the value for PSDP expenditures and it increased in FY 2019-20 to 87%(463,419 million Rupees and 533,220 million Rupees respectively). The share of pensions as a percentage of current expenditures is also increasing overtime (for FY 2019-20 it stood around 7.6%) and at the current pace it is estimated by 2050, pensions will account for 56% of current expenditure. The government will not have the funds for pension expenditure after 8-10 years.

9 Situation is worse in provinces and PSEs; pension outlay in Punjab Budget equals 95% of the revenues of the province and Railway pensions stand at 70% of its annual revenue.

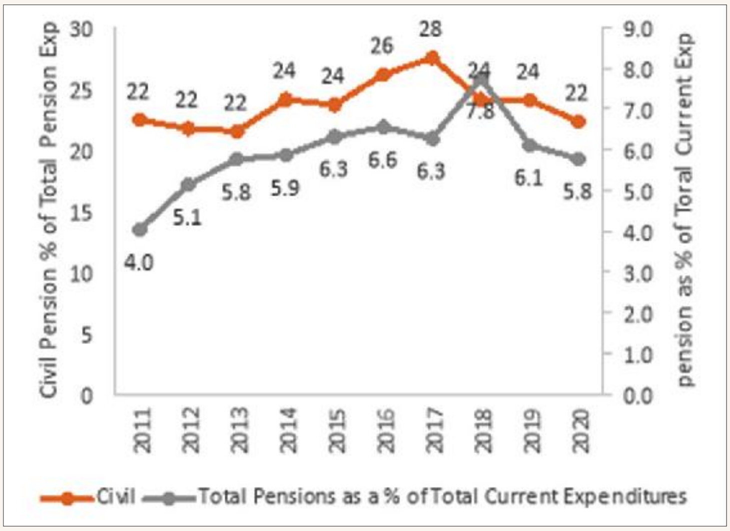
The PIDE Policy Viewpoint further states that the existing government pension system of Pakistan is fragmented, non-transparent, understudied, and without any underpinning asset base. Federal government, provincial governments, armed forces of Pakistan, autonomous bodies and other government agencies are throwing forward the pension liability without any plan on how to meet their growing burden. In case of armed services all other countries facilitate soldiers for their second careers. This, on one hand, increases the contributions towards the pension fund, and the other hand delays reimbursement of retirement benefits. It results in significant long-term savings at the national level that are mostly invested in the assets which fuel economic growth.

For Civil services having a defined benefit (DB) system which is unfunded creates barriers for entry and exit into the civil services. Turnovers are not possible because of the unrealised pension benefits. If this system is converted into a defined contribution (DC) system then employees would have more leverage for switching across jobs and help attract qualified and talented individuals in various stages of service.

However an actuarial analysis has to be done for identifying the possible benefits which these funds can offer. World over these pension funds are operated by trusts, private funds managers and even governments themselves. These funds play a pivotal role in providing for the financing requirements of the economy as well. The role of Pension Funds in the economic growth can be assessed from the fact that around 76% of assets in the US Stock Exchange are owned by the Pension Funds[10].

PIDE Policy Viewpoint reports that converting the existing system to a DC system would make the pension payouts to be sustainable in the longrun. Pension Funds usually become operative after eight years once sufficient funds have accumulated and investments have started generating revenues. It is therefore of critical importance that pensions are transformed into Contributory Funded Pension System to allow time for these funds to become operational before the prevailing system runs out of the stream.

Ministry of Finance should urgently initiate Actuarial Study and identify the major issues with government pension schemes, EOBI, and VPS (Voluntary Pension System). Future policies should be aimed at broadening participation of the general public in Pension Funds as seen in western countries.



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Debt in Pakistan: Sustainable or Not?

The developing countries are in debt trap. They need external funds since they cannot generate adequate resources domestically to achieve economic growth to improve their livelihood. In general, the government use three methods to finance their expenditures, they may increase the taxes, can print the money, and borrow the money. Due to variety of advantages of borrowing the governments prefer to borrow. Therefore, they borrow from external resources and in curdebt. Most of the times, the repayments are not easy for them, and they face debt sustainability issues, and consequently, it hits the economic growth process.

The countries incur debt due to the shortage of local finances. It is a norm in the life of countries that they incur debts. But the important question is how much is too much? That is, how much debt is beneficial for the countries and after what limit it is dangerous for the economies. It depends on the debt sustainability of the country. When a country is able to meet all its payment obligations, current and future, without taking exceptional finances from the external resources without being default is known as debt sustainable country. The sustainability of the debt of a country depends on the number of factors like the quality of institutions, debt management capacity and macroeconomic fundamentals, that is, economic growth.

There are a number of studies which give the various criteria for the sustainability of the debt which depend on the size of the economy, capacity of repayments, credit rating and various other indicators. However, the seminal study of Reinhart and Rogoff (2010) got colossal attention in this regard, which claimed that a debt to GDP ratio, which is higher than 90 %, negatively hurts economic growth. Then plenty of literature is produced to evaluate this claim. This study also links the debt sustainability with GDP growth. The literature further suggests that the tax rate increase to substitute the debt will not make a reasonable attempt in lower-income countries. However, improvement in the economic environment to create an investment-friendly environment is suggested.

Therefore, the debt-growth nexus remains a widely discussed issue in the empirical literature of economics and finance. The empirical literature can be divided into three main categories: linear negative relationship, positive linear relationship, and nonlinear relationship. Linear positive relationship implies that a country grows as the level of debt increases. Theoretically, it is an ideal condition since the economy can increase debt to encounter their developmental goals, such as developing their physical and human infrastructure. Conversely, a negative link guides that an economy's growth declines when it increases its public debt. When the debt may affect both positively and negatively, then it is known nonlinear relationship.

Debt Sustainability in Pakistan

The debt to GDP ratio has continuously increased in Pakistan's last ten years (see figure 1). Therefore, the question of fiscal sustainability is quite relevant here. Notably, we need to understand how the debt to GDP ratio will remain in a manageable range. The Fiscal Responsibility and Debt Limitation (FRDL) act suggests that the debt should remain around 60 percent of the GDP. The debt management in Pakistan is somewhat a complex issue in Pakistan *(see box 1).*

According to the International Monetary Fund (IMF) suggestion the calculation of the debt sustainability depend on three important variables, interest rate, GDP growth rates and the existing debt of GDP ratio. The higher interest rate implies that higher debt servicing, which adversely affects the debt dynamics. On the other hand, higher economic growth means a lower debt to GDP ratio. Therefore, as long as the cost of borrowing is less than the economic growth, the debt burden will not rise. Consequently, debt sustainability will be questionable in lower economic growth and high-interest rate environment in Pakistan.

Jalil (2020) develops several scenarios, based on some assumptions, to evaluate the case of Pakistan. More clearly, what should be the threshold level of economic growth to be solvent. The conclusion of the study is that at least 8 percent economic growth is required for the sustainable debt.

Conclusion

We see overwhelming evidence from the literature that there is a negative relationship between debt and economic growth. In the backdrop of Pakistan's current public debt trajectory, these outcomes should worrisome for the policymakers and the public. There is no confusion that the lower economic growth will significantly negatively impact the living of the population of Pakistan. On the other hand, high economic growth will help to reduce the debt to GDP ratios. Therefore, the policymakers should adopt a new growth strategy based on a market-friendly, investment-friendly, and transaction friendly environment.

Box 1: Existing Structure of Public Debt Management in Pakistan:

Debt management in Pakistan is scattered among various institutions and entities, most of them within Ministry of Finance. Debt management includes:

Budget Wing and Debt Policy Coordination Office (DPCO) carries out front office function of domestic wholesale borrowing (regarding target maturity, tenors to be offered, financing plan, estimated deficit and auction target) in consultation with State Bank of Pakistan (SBP), while SBP carries out the back-office functions of domestic debt management. Budget Wing and DPCO also approve the profit rates to be paid on the instruments issued by the CDNS.

Central Directorate of National Savings (CDNS) raises funding for the government in the domestic retail market (National Saving Schemes). It operates a substantial network of savings centers and also distributes products instruments through post offices and commercial banks. It handles all administrative actions associated with its instruments including selling, encashment, registration and debt servicing.

External Finance Wing deals with IMF, and carries out front office function for contracting debt from international commercial sources.

Economic Affairs Division (EAD) is responsible for raising external funds, both grants and loans, from multilateral and bilateral creditors and manages the debt management system (Debt Management and Financial Analysis System - DMFAS) in use for all external debt.

Debt Policy Coordination Office (DPCO) is organized under a separate law entitled Fiscal Responsibility and Debt Limitation Act (FRDLA). The office is responsible from preparing a debt reduction path, providing policy advice on domestic and external borrowing, monitoring and evaluating the debt reduction path and debt management strategy, providing consistent and authenticated information of government debt and guarantees and maintaining a centralized and updated record of government debt and guarantees. Agreements for guarantees on external loans are prepared and issued by the External Finance (EF) Wing, while agreements for guarantees on domestic loans are prepared and issued by the Corporate Finance (CF) Wing. DPCO gives concurrence as per FRDL Act and compiles the information regarding these guarantees. DPCO also performs front office function for contracting debt from international capital market.

To further elucidate, debt management functions in Pakistan are significantly fragmented as:

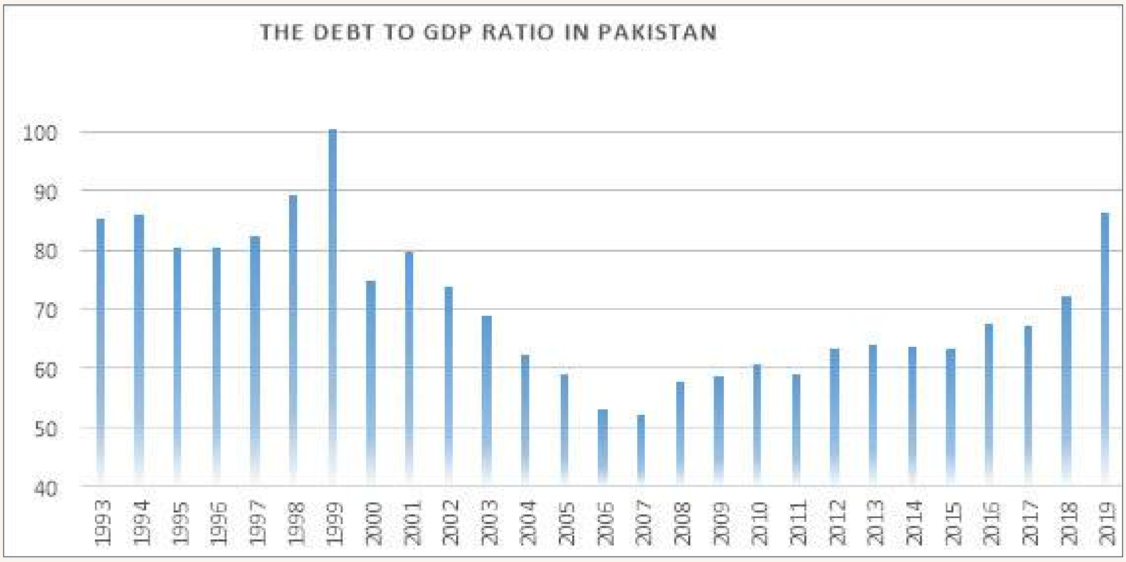
(i) Borrowing function split into five units:

I. Economic Affairs Division (EAD).
II. External Finance Wing.
III. Budget Wing.
IV. Central Directorate of National Savings (CDNS).
V. Debt Policy Coordination Office.

(ii) Debt operations, which pertains to debt recording and servicing is split into three units:

I. Economic Affairs Division (EAD).
II. Central Directorate of national Savings (CDNS).
III. State Bank of Pakistan (SBP).
iii) Risk management (Middle Office) function is being fulfilled by DPCO.

The debt to GDP ratio in Pakistan



Debt is a Problem for Us, Growth is the Solution

M. Ali Kemal

Generational effect of fiscal deficit and debt are not hidden. Growth is an answer to most of the debt and fiscal deficit issues. Higher growth in the presence of increasing debt do not create payback problems for future generations. Whereas, fiscal deficit comes with higher future interest payments hurts the growth significantly (Kemal, Siddique, & Qasim, 2017). In addition, high fiscal deficits also worsen macro indicators such as savings, interest rate, investment, and current account deficit (Bilquees, 2003).

With the same token, as explained by Qasim and Khalid (2012) fiscal responsibility is crucial for a nation to remain prosperous and stronger in future. It also determines the prosperity of our future generations. If the fiscal responsibility is not practiced the government would spend more money than its income and the rest it borrows.

Fiscal Responsibility and Debt Limitation

Fiscal Responsibility and Debt Limitation (FRDL) Act (2005) is binding fiscal responsibility for the government to limit government's access to borrowing for financing its expenditure. It explicitly ensure "that within a period of ten financial year, beginning from the first July, 2003 and ending on thirtieth June, 2013, the total public debt at the end of the tenth financial year does not exceed sixty percent of the estimated gross domestic product for that year and thereafter maintaining the total public debt below sixty percent of gross domestic product for any given year" [Debt Policy Statement (2006-07)].

Debt and Growth

Debt, undoubtedly is a double-bladed sword; use it wisely to increase welfare or vice versa. Kemal (2001) elucidates adverse effects of domestic and external debt accumulation and debt servicing on the poor. Yousuf and Mukhtar (2020) concludes that better and productive use of external debt in public sector development projects to foster the capital accumulation process in Pakistan. Similarly, Sheikh, Faridi and Tariq (2010) finds positive impact of overall debt and GDP growth, while debt servicing has negative impact on growth.

Government tends to do deficit financing in the lower growth episodes especially when the interest rate is higher. Therefore, financing is among the important problems. Financing at higher interest rate adds to higher cost of paying back. The IMF debt law of motion move around the interest rate-growth differential, that is, if interest rate is higher than the growth then then the debt to GDP will increase.

Necessary Conditions

Recent PIDE knowledge Brief # 10 analyses the growth and debt nexus using the IMF debt law of motion. The have used different scenarios based on primary balance, i.e., zero, -2.2 and -4.3.

Besides zero primary balance, for the other two levels it concludes that when growth is equal to the interest rate then debt as percentage of GDP remains the same. While, it is necessary but not sufficient that higher growth rate of GDP than interest rate is required to keep the speed of debt to GDP lower than otherwise.

For sufficient condition significant higher growth rate of GDP is required to maintain the debt to GDP ratio at the same level. It takes current level of debt to GDP ratio, i.e., 86 percent. It examines three components, at what growth rate with three primary balance scenario debt to GDP ratio remains same. How many years would it take to reach 60 percent of GDP with all three scenario? Table below explains the scenario given in the brief:

Scenarios	Primary Balance = 0	Primary Balance = -2.2	Primary Balance = -4.3
r = g = 1.5% / year	At the same level	Debt to GDP increases	Debt to GDP increases
g = 4.5%	31 years to reach 60%	Debt to GDP increases	Debt to GDP increases
g = 10%	5 years to reach 60%	6 years to reach 60%	31 years to reach 60%
GDP growth requires to keep debt at constant level	r = g = 1.5%	6.6%	8.9%

Table 1: Growth Required to Maintain Debt at Constant Level – Three Scenarios
Source: PIDE knowledge Brief # 10

Sustainability Conditions

Another study Malik and Kemal (2018) explains the similar scenario while taking different levels of overall budget deficit, i.e., 5%, 4.5%, 4%, 3.5% and 3%. Study calculates sufficient condition for maintaining debt at 60 percent of GDP. They take year 2015 as benchmark period while overall budget deficit contributes to the increase in interest payments. They get two major results from the study; what should be the sustainable growth rate of GDP required to maintain debt at 60 percent and what is the level of debt in nominal terms even if we maintain debt at 60 percent of GDP.

Malik and Kemal (2018) take 2014 as benchmark period when actual level of debt was PKR 15.996 trillion, i.e., 63% of GDP. Figure 1 shows that 5 percent fiscal deficit each year demands 15.6 percent nominal GDP growth (6.1 percent real GDP growth at 9 percent level of inflation). Whereas the required growth of nominal GDP declines to 12.26 percent (3 percent real GDP growth at 9 percent level of inflation) when fiscal deficit is at 3 percent of GDP.

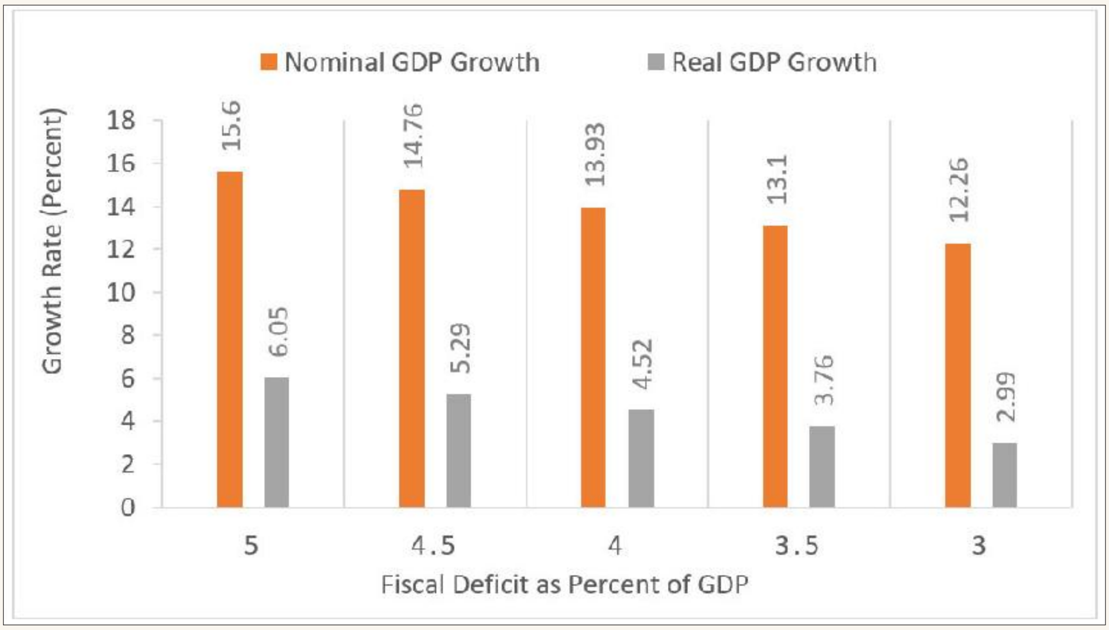


Figure 1: Required GDP Growth Rate
Source: Malik and Kemal (2018)

Debt and Productive Activities

Secondly, it is important to note that in 2014 our interest payments on the domestic debt was 4.3 percent of GDP. Whereas in 2018-19 it was 4.8 percent of GDP. Essentially, at 5 percent level of fiscal deficit was not followed. Nevertheless the calculations at 5 percent fiscal deficit tell us that to keep debt to GDP ratio at 60 percent if we can have 15.6 percent nominal GDP growth, our debt in nominal terms go up by 4.9 times by 2025 in ten years. The key is to maintain higher growth rate of GDP to sustain the debt at 60 percent of GDP. There is nothing wrong in taking debt if it is utilised in productive activities where payback is maximum.

What is Essential?

- Growth is the key to most of our problems, whether it is related to controlling unemployment, tackling inflation, increasing revenues, decreasing poverty and inequality or repayments and maintaining debt at some sustainable level.
- Higher growth rate is required to maintain debt to GDP ratio at constant level, say 60 percent of GDP.
- Higher growth rate than required would reduce the debt to GDP ratio.
- To achieve higher growth, we need to deregulate the market for the possible economic activities that are not feasible due to stifling regulations.
- Decrease “government permissions” to give relief to business activities. Permissions increase the transaction costs and create hurdles in performing normal businesses.
- Attract investment into higher returns market by removing anomalies.
- Lower reliance on government activities by either privatising the PSEs and SOEs and/or give space to private sector by reducing the government’s footprint.

Iftikhar Ahmad

Image Credits: Bussiness Recorder

National Finance Commission Awards in Pakistan; It's Time for a Revisit

Functioning federal system needs a coherent, functioning and vibrant interaction between the centre and the federating units. Once the constitutional prerequisites are accomplished, the next most important condition to make a federation work is the functioning financial arrangements. Resource generation, its availability and timely utilization is what the representatives compete for in the federal and provincial governments to make their electorate satisfied and content with the representative's efforts. Thus, both the tiers are competing against each other while seeking resources, a setting that represents a trade-off. Resultantly, the efficient resource distribution mechanism calls for the ideal Pareto efficient point where no further improvement is possible without imposing a cost on the other party. This can only be achieved through a dynamic resource distribution formula.

Resource distribution in Pakistan has always remained a bone of contention. Historically, Pakistan has excessively remained a centralized federation, with the federal government having vast powers to collect revenues, leaving provinces with exhausted avenues for revenue raising. This implies two important policy lacunas. Firstly, the provinces always needed financial assistance, which federal government provided out of the excessive funds collected at the centre. Secondly, which is even more important, is that the said practice eroded provinces' capacity to raise revenues from potential indigenous resources. Till the 7 th NFC award, the situation continued as the federal government distributed a manageable portion of additional resources among the federating units. However, the situation reversed in 2010, when it was decided that 57.5% of the total proceeds be horizontally distributed among the provinces while centre is left with 42.5% of the total divisible pool.

The given state of affairs though is applauded from the perspective of provincial autonomy, however, as obvious, this tilted arrangement has given birth to financial problems which is by no mean sustainable in the long run (NFC report, 2009). The NFC report by the government of Pakistan itself states that ***"Under the options proposed, the overall fiscal deficit would neither be consistent with the one agreed with International Monetary Fund (IMF) nor desirable for a stable economy"***. The desired proposed options, as per NFC report, given to the stakeholders were: i) provincial share at 52.5%; and ii) provincial share at 55%. Here it is important to note that both these proposed shares are below the actual 57.5% that took effect in the NFC award.

The NFC report (2009) also elaborates that in addition to vertical distribution, the weights for horizontal distribution were also decided arbitrarily without sufficient evidence and analysis on the implications. In addition, there are certain assumptions made while awarding the 7 th NFC but these are still to be realized e.g. raising Tax to GDP ratio to 15% by 2014/15 (and onwards) and low inflation rate. Similarly, the historic lethargy in generating own revenues still continues and only the low hanging fruits like property taxes or taxes on services are pursued which resulted in double taxation. On the contrary, taxes on professions (like doctors, engineers, retail etc.) along with agricultural income tax are still to be initiated/raised to its full potential in the provinces. Similar is the case with incentivising the local taxes through PFC awards.

Moreover, the award turned a blind eye to the requirements of the centre especially related to debt servicing and defence. The current fiscal resource distribution mechanism has left the centre handicapped to take any policy initiative which is of immediate nature but have financial implications (like natural calamity in the form of Covid-19, merger of erstwhile FATA, floods, agricultural catastrophe like locust attack etc.). Moreover, the 18 th constitutional amendment has also played an important role in further complicating the situation as the federal government is in a compromised situation to get into or fulfil international agreements as a number of ministries (including the environment) have been devolved to the provinces. This by no means imply that resources be centralized again but in fact a workable solution is necessary which can take care of the urgent national responsibilities as well as reward fiscal effort and discipline. Similarly, spending appropriations as per constitutional mandate and avoidance of duplication of effort needs to be checked through prudent fiscal discipline. These can only be achieved if we do away with discretionary spending and resort to evidence-based systematic transfers.

Certain provisions of the 18 th amendment have also made the award inflexible in certain ways. The 18 th constitutional amendment required that the provinces' share shall not be less than what is decided in 2009 NFC award. The non-flexibility clause added to the complexity and distorted the dynamism of the mechanism. This is reflected in the deadlocks experienced in the coming years, with no NFC awards because there is no incentive for the provinces to revisit as federal government has nothing more to offer. No revisiting means no reconsideration and no re-evaluation; an inbuilt inefficiency introduced through the 18 th amendment which is against the spirit of the whole process.

Bottlenecks still exist and will persist until significant analysis is undertaken in this regard. With respect to resource distribution in Pakistan, three issues need attention. Firstly, what channel of vertical inter-governmental transfers does Pakistan follows? If we observe the global practices, the vertical transfers' approaches can be categorized in three: need based, equity based and efficiency based. Usually, the transition happens in the same order as mentioned and is tied with the stages of development. Where does Pakistan stand and should it continue with the existing stage or graduate from it; is an academic question. If Pakistan has to move to next level, then when and how, is what needs a thorough analysis. This analysis is highly likely to have political sensitivities attached to it and would not be based on sheer economic thinking. There is also need to shed some light on the political economy of NFC as well. The unanimity rule being adopted for approval of the NFC also has led to recurrent deadlocks so we need to find a way out. In short, we need to look for out of box solutions for future allocations by having deliberations to further the debate.

Policy Perspective

To conclude, the 7 th NFC award was a bold step in Pakistan's resource distribution history, however, the situation demands further analysis to search for an optimal resource distribution mechanism where no one can externalize their inefficiencies upon the other member of the federation. The New formula is needed which can induce the centre and provinces to put in their maximum effort for optimal resource generation and to ensure spending efficiency in order to achieve the highest possible shared prosperity. The required mechanism would need best analysis to assess the needs of the population as well as the potential of the jurisdiction so that no one gets a free lunch. The new NFC formula is required not only to satisfy the expenditure needs (in wake of population needs or cost disabilities) but also to have sufficient incentives to reward efficiency and efforts.

Webinar: Federal Budget 2021-2022

Budget for the **fiscal year 2021-22** is around the corner. The new Finance Minister is expected to bring about new changes and make new announcement. He wants to negotiate on the Fund Program and also wants to encourage the new enterprises. In order to get expert opinion on the new developments in the coming budget, PIDE in collaboration with IPRI held a pre-budget webinar inviting four eminent economists to shed light on where we are and we are heading towards.

Dr. Mahmood Khalid set the stage by sharing the key budgetary proposals in the *Medium Term Budget Strategy (2021-24)*.

- All the burden of austerity has been put on the revenue side, especially FBR in the coming budget. The revenue target is expected to increased by 27% for FY 2021-22 over the last year revised target.
- From the expenditure side again federal government is to cut its current expenditures, mainly on domestic interest payment side.
- The expenditure on the federal and provincial PSDP is expected to be almost the same as in the previous years. There are new projects as well as throw forwards in the PSDP leading to cost and time over run of projects.
- Apart from this, certain fiscal benchmarks from the IMF have to be met as well specifically the reallocation of electricity subsidy burden towards the consumer.

Dr. Hafiz Pasha Recommendations

Dr. Pasha mentioned the nine month fiscal operation position of the country (July-March FY 2021):

- The budget deficit has decreased to 3.6 % of the GDP as compared to 3.8% in the last year.
- There is a big decline in the development budget, that is, 29% in the last nine months.
- The development spending reported is 277 billion rupees whereas the releases are 494 billion rupees. Provinces have a surplus of 400 billion rupees (0.8% of the GDP) which means the reduced budget is not spent where it should be spent. This means the system does not have the capacity to spend.
- The approval of the Medium Term Budget Strategy Paper by the Cabinet and the National Assembly on the basis of which IMF has given us a quarterly payment of 500 billion dollar. If the targets in the MTBSP are not met, the Fund can suspend its program.
- If the renegotiations are possible with the IMF, the Government should focus on revising the targets with them.

- If the renegotiations are possible with the IMF, the Government should focus on revising the targets with them.
- Target for a 1% decrease in the budget deficit. Target for a growth rate of 18-20 % in FBR revenues.
- Increase the capacity for the development budget which happens to be a new constraint.
- Raise development spending by 20%. Impose a moratorium on new projects.
- The tax proposal in the MTBSP and in the staff report of the IMF for withdrawing most of the exemptions in the sales tax. According to him, they are reasonable exemptions (related to food, medicine, etc). Focus should be more on the progressive taxation in terms of direct taxes.

Dr. Pervaiz Tahir Recommendations

Dr. Tahir responded to the questions posed by Dr. Haq of where the problem lies and why our fiscal machinery is broken down. He said when one doesn't think about one's problem, one keeps on having the problem.

- The Finance Minister has to do something on the expenditure side. Money should not only be released rather it should be spent somewhere, which requires capacity building.
- The focus of spending should be on the projects which are of some return, just not on useless things.
- The Federal Government should not spend in those areas which belong to the provinces after the 18 th amendment. For example: the funding of the universities should be a provincial subject.
- He proposes a pension fund for pensions specifically the military pensions as the total liabilities of the pension is over 1050 billion rupees.
- Debt to the private sector should be increased.

Dr. Vaqar Ahmad Recomendations

- According to Dr. Ahmad, the Budget Strategy Paper should be revised if the four key goals (growth, job creation, social protection, and controlling inflation) by PM in the Economic Advisory Council have to be met.
- The focus on private investment in the Budget Strategy Paper is missing without which the high targets of job creation cannot be realized.
- The efficiency of our social protection programs seems sub optimal. In order to mobilize all the social protection initiatives taken, the nation wide data bases including NADRA have to be integrated.
- Insulate the tax administration from the political influence, for that the demand of the tax body for the autonomy should be considered.
- Given the lack of capacity of the government sector, the project appraisal function should be outsourced to some independent third party.

Dr. Aqdas Afzal Recomendations

According to Dr. Afzal the lack of jobs is not only an economic problem but it is more of a social problem. In order to cope with the problem of growth, jobs and poverty, he suggested the following.

- Target for a 1% decrease in the budget deficit. Target for a growth rate of 18-20 % in FBR revenues.
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- In the short run, budget for Ehsaas/BISP has to be enhanced; to double at least.
- In the medium term, the Govt. should look forward to the privatization agenda for those State owned enterprises, not well managed by the government.
- In the long term, invest in the human capital in terms of health and education.

BOOK REVIEW

Pervez Tahir

Bangladesh's Framework for Economic Growth

Title: Numbers and Narratives in Bangladesh's Economic Development

Author: Rashed Al Mahmud Titumir

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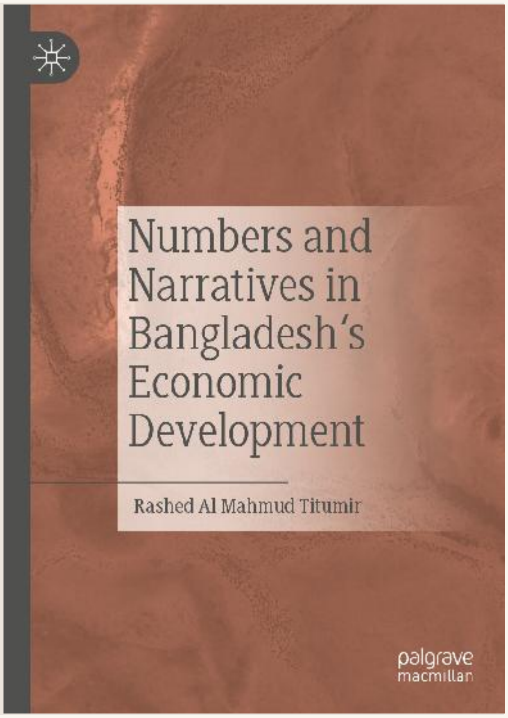

Ever since the emergence of Bangladesh, her impressive record of economic development has defied all predictions of gloom and doom. Rashed Al Mahmud Titumir, a professor at University of Dhaka, has applied a novel approach to analyse the past, construct the present narratives and test these for stability, transformability and sustainability conditions to assess the achievability of the vision to be a developed economy by 2041. The specification of these conditions may not be exhaustive, but these do point towards the desired direction of a growing economy.

The book is divided into eight chapters, each followed by references, and has an extensive index. Chapter 1 focuses on economic growth, describing it as consumption-led due to the shifts in labour force and migration. Saving and investment were stagnant. Growth was jobless, with increasing informal employment, and inconsistent with social sector development. Agriculture is the subject matter of Chapter 2. Food insecurity persists, there is little structural change and productivity has been declining. The country has been described as a manufacturing miracle. Chapter 3 tells the real story. The discussion includes production capacity, market diversification, technological catch-up and, curiously, a havoc in the manufacturing Industry. Chapter 4 brings out deterioration in quality and soundness of the financial sector. Chapter 5 points out the low skill formation and Innovation in the education sector. In Chapter 6, the health sector is shown as suffering from low public spending and unequal outcomes in key indicators. Chapter 7 reveals that high growth has reduced poverty slowly, but inequality has continued to increase. Despite some improvement, gender disparities are still prevalent. All chapters analyse the impact of the Covid-19 pandemic and the associated governance failures. Taking cues from Why Nations Fail, the concluding Chapter 8 looks at institutions, political settlement and economic outcomes to explain the political economy of growth.

The author delves deep into the parameters of the stability conditions of present growth to stay in the middle-income category, transformative conditions to achieve the East Asian level and, finally, the sustainability conditions for making it to the OECD family. Investigating the interaction between economics and politics, something that has not been done at any serious level in the case of Bangladesh, the author fills an important gap in the literature on growth in developing conomies. Is Bangladesh an exception to the rule that development is not possible without good governance? Has economic development precedence over political inclusion? The author finds that these propositions are grounded neither in theory nor in empirics.

The book, thus, investigates the numbers and narratives by analysing the necessary and sufficient conditions of development. The necessary conditions entail an incisive inquiry into the factors of economic growth—land, labour, capital and technology, while the sufficient conditions are captured by laying bare the state of play in terms of political settlement.

How did Bangladesh economy emerge from a backward province of Pakistan and the proverbial basket case after independence? The story of rapid growth in Bangladesh is not a story of high rates of saving and investment, which were mainly stagnant, but of high and accelerated rate of consumption. The known driver was the readymade garments manufacture and exports. In the wake of the relocation opportunities created by the Multi Fibre Agreement (MFA) at the international level, new factories were established by investors. They were also able to entice skilled workers and managers to profit from transferred technology and the abundant supply of cheap and captive local labour. It was the rising consumption of the local labour, not the original investment, that drove the high growth.

In the words of the author: *"Two events were particularly important in shifting the labour dynamics in the country. First, the readymade garments sector sprung up in the 1980s and was built upon the abundance of labour. The sector did not require high level of skills and hence tapped into the unskilled and semi-skilled labour force. Second, overseas employment opportunities in the Middle Eastern countries opened at the same time. This sector also relied on unskilled and semi-skilled workers. This worked in favour of the large number of unskilled workers in the agricultural sector in rural areas who migrated to urban areas and abroad for employment. The structural transformation in the economy began at that stage and only accelerated in the following decades. Readymade garments sector also had a long-lasting impact on female employment. This sector also caused migration of unemployed females from rural areas to cities. The shift from the low waged agricultural sector to the higherwaged industries and the overseas employment resulted in an increase of private consumption. The outcome of this increased consumption was a sharp reduction in poverty, especially in rural parts of the country."* High economic growth has been accompanied by significant improvements in social indicators. Interestingly, the outcome is due more to out of pocket expenditure than public investment. Great strides have been made in literacy, infant mortality and life expectancy. Notably, women live longer than men. Skill formation has, however been painfully slow.

Figure 1

Figure 1 lays out author's framework of growth proposed for the Bangladesh economy. Greater utilisation of labour, rising consumption, improved social indicators and increased development spending ushered in a long period of stable economic growth since 1975. It did not, however, translate into improved standard of living. The author identifies four challenges here: lack of skilled workforce, stagnant investment, declining capacity of government spending and the latest entrant, the COVID-19 shocks and waves. Overcoming these challenges requires the fulfilment of transformative conditions. Increased level of skills in the workforce, higher level of productivity and increased real wages are the obvious ones. The most important condition is that of functioning institutions. Only then will result transformational economic growth with a higher living standard. A major challenge faced by the transformational growth is the lack of public provisioning of social goods. But the most serious challenge to transformation is posed by the authoritarian clientelism and neopatrimonialism.

The country had its share of military and hybrid regimes during 1975-1990. This period is characterised as authoritarian clientelism. It bred an intermediate class, consisting of "rich and middle farmers, urban petty bourgeoisies and educated middle classes, having a greater degree of organisational ability resulting from their better education and greater wealth." It wielded the power to extract rents from the state by aligning with an authoritarian regime. This class exploited the large bulk of the opportunities post-MFA. Most of the owners of readymade garments factories were retired bureaucrats and military officers. Under the democratic political settlement during 1990-2007, the clientelism continued though it became somewhat competitive and therefore more pro-growth. Some of the highest levels of growth in the readymade garments sector were witnessed during this period. As the government deregulated, subsidised and allowed tax holidays, the sector really took off to be next only to China. By 2017, exports touched $28 billion, absorbing 4 million workers, mostly women.

It will not be possible to transform this quantitative achievement into inclusive development unless political settlement puts to an end the reproduction of neopatrimonial political activists bending institutions ad infinitum towards rent seeking. According to the author, “The clientelist resource-dependent networks, for perpetuating their objective of accumulation of wealth and power, are symbiotically connected at a vertical layer (local, regional, and national) and are intrinsically interlinked at the horizontal level with business, administration, law-enforcing agencies and the judicial system. The ever-increasing hunger for accretion of economic rents wants an exclusive political system to spread all over the horizontal and vertical levels, creating a culture of occupying a position—from member of parliament down to the chairman of the Union Parishad—uncontested or without any competition from opposition political parties. The process of fear and exclusivity has created a sense of low business confidence, which has resulted in depressed investment demand, leading to a reduction in job creation. The economic rents also fly out from the country as exhibited through increased capital flight from Bangladesh.” Export success, it must be remembered is not the direct result of competitiveness. As a least developed country, Bangladesh enjoys duty free access under the GSP facility in the European Union. This is likely to end by 2024. The subsequent graduation to GSP plus status will disturb the conditions of stable growth. Again, recent years have seen a deceleration in the rate of poverty reduction. The elasticity with respect to growth has declined. This may be the result of the rigidity of the distribution of income as well as wealth.

So the necessary conditions to reach Bangladesh’s vision of a developed economy by 2041 are not in sight. For growth to be sustainable, another set of conditions must be met. New drivers have to be operationalised. These include sustainable resource management and human-nature relationship. The expected outcome is sustained economic growth and living in harmony with nature. On this road, the challenges to be faced up to are government policies, norms and values, global warming and climate change.

The author’s view of the political economy of Bangladesh bears repeating: “The political process in Bangladesh has evolved in a particular direction, corresponding to the characteristics of political activists and the incentive-structure to reproduce the political system. The particular form of materialist incentives of primitive accumulation of resources through use of power and coercion has led to a system of clientelist political networks in Bangladesh.” The system has generated growth, but mainly for the non-labour player and, therefore, not sustainable.

The book is an important addition to the literature on development studies in general and political economy of South Asia in particular. It contains useful leads and insights on the process of growth in less developed economies and provides interesting guidelines to construct a growth framework. Its main takeaway is that quantitative growth cannot be sustained in the long run without improving its quality. In this the role of a participatory state is crucial.

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