ECONOMY OF TOMORROW

FRIEDRICH EBERT STIFTUNG

Progressive Fiscal Policy for Inclusive Growth

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- Fiscal Policy is one of the key elements on the way to achieve a socially just, sustainable and dynamic growth model. It relates to fundamental questions defining the role of the state in promoting economic development and providing public services to its citizens.

- In order to address the existing social and economic inequalities in Pakistan, Progressive Fiscal Policy Reforms must focus on direct taxation of land, property and income. The allocation of public expenditure needs to prioritize social protection programs as well as social services like education and health on the one hand and set incentives for economic sectors with high employment potentials on the other.

- Beyond the policy challenges, this study analyzes the Political Economy of Fiscal Policy in the current context of Pakistan. Given the prevailing power structures, it highlights a number of recommendations how to implement a more progressive taxation policy. Based on extensive research and discussions, the author also proposes an Alternative Medium Term Budget Strategy, both on the revenue and expenditure side.

ACRONYMS

- ABS Annual Budget Statement
- ACGR Annual Compound Growth
- ADP Annual Development Program
- ADT Avoidance of Double Taxation
- AIT Agricultural Income Tax
- AJ&K Azad Jammu and Kashmir
- AOPs Association of Persons
- APTMA All Pakistan Textile Mills Association
- BISP Benazir Income Support Program
- BOR Board of Revenue
- CAD Current Account Deficit
- CCT Conditional Cash Transfer
- CIT Corporate Income Tax
- CPEC China-Pakistan Economic Corridor
- CPI Consumer Price Index
- CVT Capital Value Tax
- DDP Delivered Duty Paid
- DISCOs Power Distribution Companies
- EAD Economic Affairs Division
- EOBI Employees Old-Age Benefits Institution
- ERRA Earthquake Rehabilitation and Reconstruction Agency
- ESAF Extended Structural Adjustment Facility
- ESCAP Economic and Social Commission for Asia and the Pacific
- ESSI Employees Social Security Institution
- FATA Federally Administrated Tribal Areas
- FBR Federal Board of Revenue
- FCF Federal Consolidated Fund
- FDI Foreign Direct Investment
- FSI Food Security Index
- GARV Gross Annual Rental Value
- G-B Gilgit-Baltistan
- GENCO Government Power Generation Company
- GER Gross Enrolment Rate
- GIC Growth Incidence Curve
- GRP Gross Regional Product
- GST General Sales Tax
- HDI Human Development Index
- HEC Higher Education Commission
- HIES Household Integrated Economic Survey

- HSD High Speed Diesel
- IDPs Internally Displaced Persons
- IMF International Monetary Fund
- IPPs Independent Power Producers
- IPR Institute of Policy Reforms
- IRS Internal Revenue Service
- IT Information Technology
- ITO Income Tax Ordinance
- KESC Karachi Electric Supply Company
- K-PK Khyber Pakhtunkhwa
- LDO Light Diesel Oil
- LFPR Labor Force Participation Rate
- MDGs Millennium Development Goals
- MNA Member National Assembly
- MNCs Multinational Corporations
- MOF Minister of Finance
- MPA Member Provincial Assembly
- MTBS Medium-Term Budget Strategy
- MW Megawatts
- NADRA National Database & Registration Authority
- NATO North Atlantic Treaty Organization
- NER Net Enrolment Rate
- NFC National Finance Commission
- NHA National Highways Authority
- NICL National Insurance Company Ltd.
- NTDC National Transmission and Dispatch Company Limited
- NTN National Tax Number
- OMC Oil Marketing Company
- P & D Planning and Development
- PAEC Pakistan Atomic Energy Commission
- PASSCO Pakistan Agricultural Storage & Services Corporation Ltd
- PBS Pakistan Bureau of Statistics
- PDF Pakistan Development Fund
- PFCs Provincial finance commissions
- PIA Pakistan International Airlines
- PIBs Pakistan Investment Bonds
- PIT Presumptive Income Tax
- PM's Prime Minister
- PML-N Pakistan Muslim League – Nawaz
- PNRA Pakistan Nuclear Regulatory Authority
- POL Pakistan Oilfields Limited

- PPAF Pakistan Poverty Alleviation Fund
- PPP Pakistan People's Party
- PPRA Punjab Procurement Regulatory Authority
- PRA Punjab Revenue Authority
- PRAL Pakistan Revenue Automation (Pvt.) Ltd.
- PRSP Poverty Reduction Strategy Paper
- PSDP Public Sector Development Programme
- PSEs Public Sector Enterprises
- PSLM Pakistan Social and Living Standards Measurement Survey
- PSO Pakistan State Oil
- PWP Peoples Works Program
- SBP State Bank of Pakistan
- SECP Securities and Exchange Commission of Pakistan
- SMEs Small and Medium Enterprises
- SPDC Social Policy and Development Centre
- SRB Sindh Revenue Board
- SROs Statutory Regulations and Orders
- SUPARCO Pakistan Space and Upper Atmosphere Research Commission
- TCP Trading Corporation of Pakistan (Pvt.) Ltd
- TDS Tariff Differential Subsidy
- UIPT Urban Immovable Property Tax
- UNDP United Nations Development Programme
- USC Utility Stores Corporation
- VIPs Very Important Persons
- WAPDA Water and Power Development Authority
- WHT Withholding Tax
- WPPF Workers' Profit Participation Fund
- WWF Worker's Welfare Fund

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FOREWORD

The "Economy of Tomorrow" and the importance of Fiscal Policy

In 2013, the "Economy of Tomorrow" (EoT) project was established by the FES Pakistan office. In times of an instable economic environment both domestically as well as internationally, FES set up a platform for debating economic policy challenges. The aim of this new working line is not only to analyze the past performance and to properly understand the current situation, but also to develop proposals for achieving a more inclusive economic growth model. In the context of the predominant neoclassical paradigm, the project started on the conviction that an alternative narrative is needed in order to form new alliances including a wide range of different stakeholders. Beyond the important academic basis and the relevant policy debates, the "EoT" project also seeks to connect economic thinking to a broader normative vision which is lacking in common perceptions about the economy: the "Good Society" with full capabilities for all.

After creating the basic understanding of economic policy challenges for Pakistan in the "EoT country study" in early 2014, we decided to focus on a number of core policy areas for developing a progressive reform agenda. A crucial factor for economic policy making is the relationship between the state and its different entities and the private sectors, as well as the way in which the workers, and more broadly, consumers and citizens of a country are dealt with. Fiscal Policy can be a key instrument to address the existing social and economic inequalities if taxation and allocation of public expenses follow the right priorities. This study wants to contribute to a healthy public debate about setting the right priorities and about finding a consensus on the way towards a more socially just, sustainable and green dynamic growth model for Pakistan.

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Resident Director
FES Pakistan
Islamabad, November 2014

Chapter 1:

INTRODUCTION

Progressive fiscal policy is based on the fundamental premise that the objective is to achieve inclusive growth. This is growth which is not accompanied by increasing inequality and benefits all segments of the population.

1.1 Fundamental Rights in the Constitution

The Constitution of the Islamic Republic of Pakistan, inclusive of all amendments, explicitly highlights the fundamental rights of citizens in Articles 1 to 45, as follows:

Article	
9	***Security of Person***
	No person shall be deprived of life or liberty saves in accordance with the law.
11	***Slavery, forced labour, etc. prohibited***
	(3) No child below the age of fourteen shall be engaged in any factory or mine or any other hazardous employment.
15	***Freedom of Movement***
	Every citizen shall have the right to remain in, and, subject to any reasonable restriction imposed by law in the public interest, enter and move freely throughout Pakistan and to reside and settle in any part thereof.
18	***Freedom of Trade, business or profession***
19A	***Right to Information***
	Every citizen shall have the right to have access to information in all matters of public importance subject to regulations and restrictions imposed by law.
23	***Provision as to Property***
	Every citizen will have the right to acquire, hold and dispose of property in any part of Pakistan, subject to the Constitution and any reasonable

restrictions imposed by law in the public interest.

*of significance from the viewpoint of inclusive growth.

Article

24 ***Protection of Property Rights***

25 ***Equality of Citizens***

(1) All citizens are equal before law and are entitled to equal protection of law.

(2) There shall be no discrimination on the basis of sex.

(3) Nothing in this article shall prevent the State from making any special protection for the protection of women and children.

25A ***Right to education***

The State shall provide free and compulsory education to all children of the age of five to sixteen years in such manner as may be determined by law.

27 ***Safeguard against discrimination in services****

(1) No citizen otherwise qualified for appointment in the service of Pakistan shall be discriminated against in respect of any such appointment on the ground only of race, religion, caste sex, residence or place of birth.

Adherence to the above articles will clearly result in inclusive growth. Progressive fiscal policy must be consistent with these articles.

32 ***Promotion of local Government institutions.***

The State shall encourage local Government institutions composed of elected representatives of the areas concerned and in such institutions special representation will be given to peasants, workers and women.

33 ***Parochial and other similar prejudices to be discouraged.***

The State shall discourage parochial, racial, tribal, sectarian and provincial prejudices among the citizens.

34 ***Full participation of women in national life.***

Steps shall be taken to ensure full participation of women in all spheres of national life.

35 ***Protection of family, etc.***

The State shall protect the marriage, the family, the mother and the child.

34 ***Protection of minorities.***

The State shall safeguard the legitimate rights and interests of minorities, including their due representation in the Federal and Provincial services.

37 ***Promotion of social justice and eradication of social evils.***

The State shall:

(a) promote, with special care, the educational and economic interests of backward classes or areas;

(b) remove illiteracy and provide free and compulsory secondary education within minimum possible period;

(c) make technical and professional education generally available and higher education equally accessible to all on the basis of merit;

(d) ensure inexpensive and expeditious justice;

(e) make provision for securing just and humane conditions of work, ensuring that children and women are not employed in vocations unsuited to their age or sex, and for maternity benefits for women in employment;

(f) enable the people of different areas, through education, training, agricultural and industrial development and other methods, to participate fully in all forms of national activities, including employment in the service of Pakistan;

38 ***Promotion of social and economic well-being of the people.***

The State shall:

(a) secure the well-being of the people, irrespective of sex, caste, creed or race, by raising their standard of living, by preventing the concentration of wealth and means of production and distribution in the hands of a few to the detriment of general interest and by ensuring equitable adjustment of rights between employers and employees, and landlords and tenants;

(b) provide for all citizens, within the available resources of the country, facilities for work and adequate livelihood with reasonable rest and leisure;

(c) provide for all persons employed in the service of Pakistan or otherwise, social security by compulsory social insurance or other means;

(d) provide basic necessities of life, such as food, clothing. housing, education and medical relief, for all such citizens, irrespective of sex, caste, creed or race, as are permanently or temporarily unable to earn their livelihood on account of infirmity, sickness or unemployment;

(e) reduce disparity in the income and earnings of individuals, including persons in the various classes of the service of Pakistan; 41[] 41

(f) eliminate riba as early as possible

(g) the shares of the Provinces in all federal services, including autonomous bodies and corporations established by, or under the control of, the Federal Government, shall be secured and any omission in the allocation of the shares of the Provinces in the past shall be rectified.

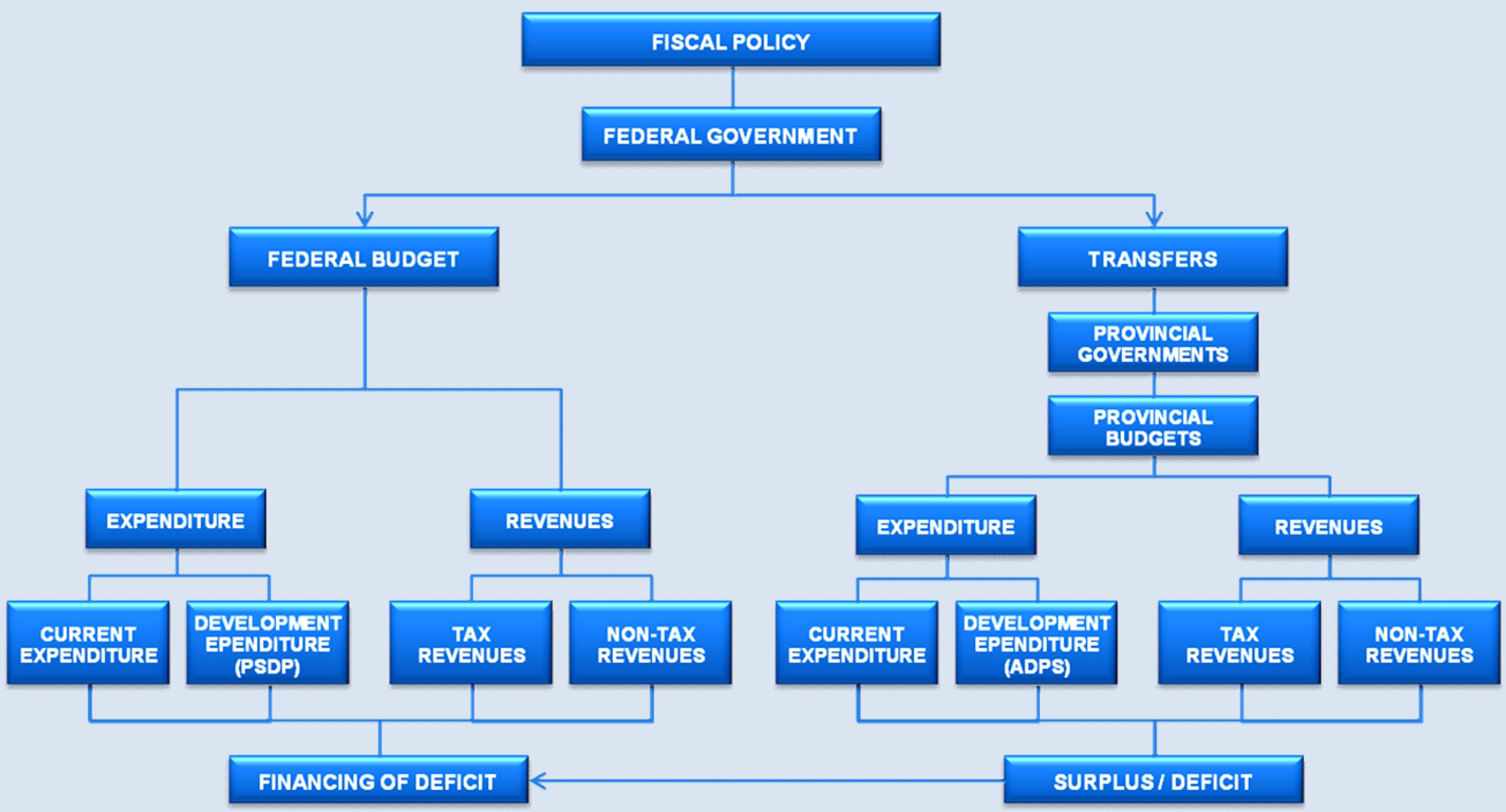
1.2. Key Elements of Fiscal Policy

As highlighted in Chart 1.1, Fiscal Policy includes both Federal and Provincial Governments. Local Governments will also fall in the domain of fiscal policy once they are constituted after elections.

The areas of fiscal policy include, first, mobilization of resources, both tax and non-tax. Second, allocations of both current and development expenditure are an important part of fiscal policy. Third, transfers from the Federal to the Provincial Governments are decided upon by the National Finance Commission (NFC), a statutory body. Fourth, how the resulting deficit is to be financed also falls within the ambit of fiscal policy.

Chart 1.1

Components of Fiscal Policy



Chapter 2:

DEFICITS IN INCLUSIVE GROWTH

The failure or success of past fiscal policy can be judged by determining the existing deficits in inclusive growth. This will also highlight the magnitude of challenge for progressive fiscal policy, once it is adopted.

2.1. Inequality in Wealth

The primary manifestation of inequality is in the ownership of agricultural land, property and financial assets.

2.1.1. Land Distribution

Feudalism still exists in Pakistan. Large landlords account for a significant part of the ownership of the available agricultural land, as shown in Table 2.1.

Table 2.1

Ownership of Agricultural Land, 2010

Farm Size (Areas)	Percentage of Farms	Percentage of Farm Area
Under 1.0	15.2	1.0
1.0 to 2.5	28.3	6.9
2.5 to 5.0	21.2	11.4
5.0 to 7.5	13.7	12.3
7.5 to 12.5	11.1	16.5
12.5 to 25.0	6.8	17.7
25.0 to 50.0	2.5	12.7
50.0 to 100.0	0.8	7.8
100.0 to 150.0	0.2	2.6
150.0 and above	0.2	11.6
TOTAL	100.0	100.0

Source: Agricultural Census, 2010

The distribution of agricultural land is highly unequal. Small farmers, with less than 5 acres, constitute as much as 65 percent of the farming population, but own only 19 percent of the farm area. At the upper end, there are about 26,000 farmers only (0.4 percent of the total) who own as much as 14 percent of the land.

The Gini coefficient of agricultural land distribution in Pakistan is very high at about 0.60. it is larger than in other South Asian countries. Also, it has shown little tendency to decline over time.

Large landlords have preferential access to irrigation water. They are mostly the owners of tractors, tube wells and other agricultural equipment. They also wield enormous political power. The majority of MNAs/MPAs are large landowners, especially in the provinces of Punjab and Sindh.

2.1.2. Distribution of Property

The Household Integrated Economic Survey (HIES) gives data for different quintiles on income (rental or imputed) from property. The distribution is given in Table 2.2.

Table 2.2
Distribution of Property Income by Quintile, 2011-12

Quintile	Percentage of Total Income	Percentage of Property Income
1	11.2	6.6
2	14.2	10.2
3	16.8	13.1
4	20.7	18.3
5	37.0	51.8
TOTAL	100.0	100.0

Source: HIES

As expected, income from property is more unevenly distributed than total income. The top 20 percent of population accounts for almost 52 percent of property income.

2.1.3. Financial Assets

Wealth in the form of financial assets is also characterized by a very skewed distribution. In the banking system, the top 1 percent of depositors account for 80 percent of the deposits according to the SBP. Similarly, banks extend 77 percent of the credit to the top 1 percent of borrowers.

Turning to the ownership of shares/securities, it is estimated that there are less than one million shareholders of publicly quoted companies. The market capitalization of $70 billion is part of the wealth of these one million individuals. Ownership of individual companies is highly concentrated. Family ownership of companies is still the dominant form of corporate ownership in the country.

2.2. Inequality in Income

Pakistan is characterized by moderate levels of inequality in income. But this is not necessarily a reflection of the ground reality. It is due to massive underreporting of income. The HIES, from which Gini coefficients of income distribution are derived, captures only half the total household income in the country. Much of the underreporting is in the upper most quintile, because of fear of detection of tax evasion.

The reported Gini coefficients are presented in Table 2.3. They reveal little change in income inequality in the country.

Rural inequality is somewhat lower than urban inequality. The former has decline somewhat while the latter has increased marginally since 2001-02.

Table 2.3

Gini Coefficient of Income Distribution

Gini Coefficient	2001-02	2004-05	2010-11
Rural	0.34	0.35	0.37
Urban	0.44	0.43	0.41
TOTAL	0.41	0.41	0.41

Source: SPDC (2012)

However, the Gini Coefficient is generally considered as a not sensitive indicator of changes in income distribution. A better and more direct indicator of the extent of inclusive growth is the Growth Incidence Curve (GIC). The GIC for urban, rural and total income is given in Chart I. Estimates of real household income growth rate in different quintiles between 2001-02 and 2011-12 are presented in Table 2.4.

Table 2.4
Annual Growth Rate of Real Household Income
by Quintiles, 2001-02 to 2011-12
(%)

Quintile	Rural	Urban	Total
1	1.7	0.5	1.5
2	2.5	0.7	2.1
3	2.9	1.4	2.5
4	3.1	2.8	3.4
5	5.5	3.3	4.0

Source: HIES

The GICs confirm that household incomes in the upper quintiles have grown much faster than that in lower quintiles, both in the urban and in the rural areas. This is confirmation of the fact that the growth process has not been very inclusive between 2001-02 and 2011-12. The rich have benefited disproportionately more.

2.3. Regional Disparities

IPR [2014] has made estimates of the Gross Regional Product of each Province. The resulting magnitudes for 2012-13 and presented in Table 2.5 below.

Table 2.5
GRP, population and per capita GRP by Province, 2012-13

	GRP at factor cost (constant prices) (Billion Rs)	Population (Million)	Per Capita GRP (Rs)
Balochistan	463.7 (4.70)*	9.5 (5.30)*	48810 (0.884)**
Khyber Pakhtunkhwa	1134.0 (11.49)	24.8 (13.88)	45726 (0.819)
Punjab	5346.6 (54.18)	100.2 (56.10)	53359 (0.966)

Sindh	2923.4 (29.63)	44.1 (24.69)	66290 (1.200)
Pakistan	9867.7	184.3	55250
*Share I **Ratio to national average			
Source: IPR (2014)			

The ranking of the four Provinces is Sindh, followed by Punjab, Balochistan and K-PK. The last Province does better in terms of Gross Regional Income, due to the relatively large inflow of home remittances on a per capita basis.

Is the present position of the Provinces a consequence of increasing or decreasing regional income equality? The answer is given in Table 2.6.

Table 2.6
Growth Rate of GRP by Province
1999-2000 to 2012-13
ACGR (%)

	1999-2000 to 2007-08	2007-08 to 2012-13	1999-2000 to 2012-13
Balochistan	3.1	1.9	2.6
Khyber Pakhtunkhwa	5.5	5.1	5.3
Punjab	4.8	3.4	4.2
Sindh	6.2	2.1	4.6
Pakistan	5.2	2.9	3.9

Source: IPR (2014)

For the period, 1990-2000 to 2012-13, the results are very counter-intuitive. Terrorism has affected K-PK the most, yet it has the highest growth rate. Why? The services sector of the province, mostly the informal economy, has done well. Growth rates of transport and communications at 5.8 percent, wholesale and retail trade at 5 percent, ownership of dwellings at 6.5 percent and social and community services at 7 percent, are all relatively high. They reflect the impact of NATO supply movement, illicit trade with Afghanistan and inflow of remittances.

The province which has really fallen behind is Balochistan, with a GRP growth rate of only 2.6 percent. The insurgency in the province is one of the main factors, although the 2010

NFC Award gave a very favorable award to the Province. It appears that in Balochistan there has been little increase in real per capita income over the thirteen year period.

The province of Sindh showed exceptional dynamism in the Musharraf period, with growth in excess of 6 percent. This was due primarily to the buoyancy of the industrial sector in these years. Since 2007-08 however, the economy of Sindh has been plagued by serious law and order problems (including target killings) and the growth rate has plummeted to only 2 percent.

Punjab has shown less deviation from the national growth rate, being the largest regional economy. In the first period it showed less growth, but has caught up in the second period.

Overall, there is evidence that regional inequality increased in the Musharraf period, a period of relatively fast growth. In the last five years, there has been some improvement in regional inequality.

2.4. Employment Trends

Given the favorable age distribution ('the demographic dividend') the labor force of Pakistan has been expanding at over 3 percent per annum. From 2001-02 to 2007-08, a period of relatively high economic growth, the overall Labor Force Participation Rate (LFPR) declined, because of higher enrolment of youth in the education system. The unemployment rate fell significantly from over 8 percent to almost 5 percent.

The significant development is the big increase in LFPR of females. A positive interpretation is that the social barriers, employment of women, especially the education, are gradually breaking down. However, an alternative explanation, especially for the latter period, is that high inflation and rise in the cost of living are forcing women to seek employment, even in residual jobs, to supplement family incomes.

Between 2007-08 and 2012-13, conditions in the labor market have visibly deteriorated. Unemployment rates of youth and females are approaching double-digits. Bulk of the jobs, outside agriculture, has been found in the informal sector, where 'decent work' is generally not available. The incidence of underemployment has also increased.

During 2013-14, it is estimated that 1.8 million persons entered the labor force. 1.2 million found some kind of a job. 600,000 new workers are unemployed. Consequently, the overall unemployment rate has increased from 6.2 percent to 7 percent.

Table 2.7
Labor Force Participation Rate and Unemployment Rate by Gender and Youth, 2001-02 to 2012-13
(%)

	2001-02	2007-08	2012-13
Total			
LFPR*	43.3	45.2	45.7
Unemployment Rate	8.3	5.2	6.2
Male			
LFPR*	70.3	69.5	68.9
Unemployment Rate	6.7	4.3	5.4
Female			
LFPR*	14.4	19.6	21.5
Unemployment Rate	16.5	8.5	9.0
Youth (15-29 years)			
LFPR*	37-54	37-54	36.58
Unemployment Rate	6-16	3-8	6-11

*Above ten years
Source: Labor Force Survey, PBS.

2.5. Food Security

A modicum of food security is essential to prevent the increase in malnutrition and poverty. This is one area in which Pakistan has done poorly since 1999-2000.

According to the FAO, the definition of food security is as follows:

> *'Food security exists when all people, at all times, have physical and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life'.*

A Food Security Index (FSI) constructed for this study reveals that the Index has been consistently declining, as shown in Table 2.8. All four components of FSI are falling. The most significant decline is in the affordability index, as food prices have generally risen faster than the overall Consumer Price Index (CPI). Also, what is not so well known is that food production per capita has fallen by almost 15 percent since 1999-2000. This is a reflection of the policy neglect of agriculture, especially in the Musharraf period, along with the impact of draughts and floods.

Table 2.8
The Food Security Index
(1999-2000 =100)
(%)

Year	Food Availability Per Capita* Index	Food Production Per Capita Index	Food Prices (Relative) Index	Self-Sufficiency Index	Food Security Index (FSI)
W	0.40	0.25	0.25	0.10	
1999-2000	100.00	100.00	100.00	100.00	100.00
2000-01	99.68	90.36	100.80	97.15	
2001-02	89.94	83.78	101.81	78.57	
2002-03	85.93	86.33	102.13	82.89	
2003-04	85.93	86.33	102.13	82.89	
2004-05	83.65	92.50	98.87	81.20	
2005-06	89.25	91.42	98.72	83.45	
2006-07	90.83	93.57	96.45	87.46	
2007-08	88.47	91.70	92.64	82.76	89.75
2008-09	89.01	98.38	90.44	82.80	
2009-10	88.64	89.00	89.95	85.30	
2010-11	88.83	89.74	8.78	84.06	
2011-12	89.20	84.67	82.41	83.64	

2012-13	89.93	85.34	82.81	84.93	
2013-14P	89.93	85.30	82.65	84.07	86.36

P = Projected
Source: Estimated by Author from PES, PBS

2.6. Incidence of Poverty

As described above, the rising inequality in wealth and incomes; growing regional disparities; worsening labor market conditions and greater food security, all imply that poverty has been increasing in Pakistan.

Unfortunately, incidence of poverty has become a hotly disputed number. No official estimates exist after 2004-05. However, credible estimates have been made by SPDC (2012) from the HIES data base. These estimates are given in Table 2.9.

Table 2.9
Incidence of Poverty, Urban and Rural
(% of Population)

	Urban		Rural		Total	
	2004-05	2010-11	2004-05	2010-11	2004-05	2010-11
Punjab	27.24	31.35 (4.11)*	27.89	37.12 (9.23)	27.69	35.30 (7.61)
Sindh	24.32	30.75 (6.43)	29.93	45.34 (15.41)	27.18	38.30 (11.12)
K-PK	41.41	48.31 (6.90)	34.31	39.58 (5.27)	35.41	41.06 (5.65)
Balochistan	47.62	51.09 (3.47)	54.38	43.40 (-10.98)	53.11	45.24 (-7.87)
Total	27.68	33.11 (5.43)	30.74	39.42 (8.68)	29.76	37.33 (7.57)

*Annual Growth Rate
Source: SPDC (2012)

The results are very striking. The incidence of poverty nationally has increased about 30 percent in 2004-05 to over 37 percent in 2010-11. In effect, 3 million people have been falling below the poverty line every year, especially after 2007-08. This is a large number and indicates how dire the situation is.

Rural poverty has increased faster than urban poverty. Not only has agriculture done poorly, but the non-farm rural economy is small and stagnant in most parts of the country.

The incidence of poverty is the highest in Balochistan, at over half the population. This implies that the roots of insurgency in the Province can be found in economic backwardness. A surprising finding is that the fastest growth in the incidence of poverty is in Sindh. This is a reflection of the highest level of intra-regional inequality in the Province.

2.7. Human Development

Finally, UNDP (2013) reveals a slowing down in the rate of improvement of the Human Development Index (HDI) of Pakistan, as shown in Table 2.10. This is clearly an indication of underinvestment on the people, especially in education and health.

Table 2.10
HDI of Pakistan

Year	Index	Annual Growth Rate (%)
2000	0.419	
2005	0.485	3.0
2010	0.512	1.1
2012	0.515	0.3

Source: UNDP, Human Development Report, 2013

There are also large disparities in access to basic economic and social services. The provincial magnitudes of these indicators are presented in Table 2.11.

Table 2.11
Regional Disparities in Social and Economic Indicators
2012-13
(%)

Indicator	Punjab	Sindh	K-PK	Balochistan	Pakistan
EDUCATION					
Literacy Rate[1]	62	60	52	44	60
Primary Education					
GER[2]	98	81	91	73	91
NER[3]	62	52	54	45	57
Middle Education					
GER	60	48	61	39	56
NER	25	19	21	14	22
Matric Education					
GER	62	54	58	37	59
NER	15	12	10	6	13
HEALTH					
At least one Immunization[4]	98	98	98	92	98
Full Immunization[4]	89	74	76	53	82
Pre-Natal Consultation[5]	73	68	59	50	69
Post-Natal Consultation[5]	28	35	23	23	29
HOUSING					
Access to Electricity	95	91	94	79	93
Access to Gas	36	53	26	23	38
Access to Tap Water	24	43	45	35	32
Access to Flush Toilet	77	63	71	30	71

[1] of persons aged 10 years and above | [2] Gross Enrolment Rate | [3] Net Enrolment Rate
[4] of children aged 12-23 months | [5] of pregnant women aged 15-49 years

Source: PBS, Pakistan Social and Living Standards Measurement (PSLM) Survey.

Punjab generally has better indicators than other provinces. Next are Sindh and K-PK. The backwardness of Balochistan is clearly demonstrated.

Further, the extent of gender inequality is very pronounced in Pakistan as shown in Table 2.12. The literacy rate is lower by 23 percentage points. The biggest difference in gross enrolment rate is at the secondary level. The unemployment rate is substantially higher and the average wage much lower.

Table 2.12
Indicators of Gender Inequality
2012-13
(%)

	Male	Female	Ratio
EDUCATION			
Literacy Rate[1]	71	48	68
Primary Education			
GER[2]	98	83	85
NER[3]	61	54	89
Middle Education			
GER	62	57	92
NER	23	21	91
Secondary Education			
GER	67	49	73
NER	13	13	100
LABOUR FORCE AND EMPLOYMENT			
Labor Force Participation Rate[4]	69	22	32
Unemployment Rate	5.4	9.0	167
Average Wage (Rs per month)[5]	12804	7868	61

[1] of persons aged 10 years and above | [2] Gross Enrolment Rate | [3] Net Enrolment Rate
[4] of persons aged 10 years and above | [5] of employees

Source: PBS, PSLM and LFS.

2.8. Key Elements of Progressive Fiscal Policy

The deficits in inclusive growth identified in the above sections have important implications for the design of a progressive fiscal policy, as follows:

(i) Tax policy must focus on more progressive direct taxation to reduce inequality in wealth and income. They key areas of focus are agricultural income, property and unearned capital income from financial assets.

(ii) The policy on inter-governmental transfers will have to focus even more on reduction in regional disparities. Inter-regional inequality is an issue to be taken by NFC. The PFCs (yet to be reconstituted) will have to design appropriate revenue-sharing formula to tackle intra-regional inequality.

(iii) The allocation of development funds will need to prioritize sectors with maximum employment potential like agricultural and rural development, small-scale manufacturing, construction, etc.

(iv) Appropriate policies will have to be designed for social protection programs generally for the poor, and in particular for workers, women, youth, minorities, etc.

(v) Food prices and affordability will have to managed through appropriate pricing of agricultural inputs, support prices for outputs and income supplement programs.

(vi) A higher share of public expenditure will have to be devoted to social services, especially education and health.

CHAPTER 3

POLITICAL ECONOMY OF FISCAL POLICY

The desired focus of fiscal policy on deficits of inclusive growth is limited by what can be broadly called 'political economy' considerations. Many of these are identified below.

3.1. Centralization of Power

The so-called 'establishment' in Pakistan consisting of the coalition of the military and the civilian bureaucracy has ensured since Independence that the country remains a 'security state' rather than a 'developmental state'.

The obsessive concern for security has implied that power must remain 'centralized', lest there be some loss of control. As such, sub-national governments have been kept week and subject to manipulation. This has been achieved by creating a state of 'dependency', whereby provincial governments have been granted limited fiscal powers and forced to survive primarily on the basis transfer of resources from the Federal Government.

It is a paradox that the golden era for local governments has been during the tenure of military governments (for 32 years out of the 67 years of Pakistan). Military governments have weakened the units of the Federation and set up a multitude of small local governments. These are seen as less of a 'threat' and as a substitute for democracy.

The centralization is also reflected in the allocation of functions, whereby the principle of 'subsidiarity' has seldom been applied. The original Constitution of 1973 contained two lists of functions – a Federal Legislative List and Concurrent List. The latter could be performed by either or both Federal and Provincial Governments. In practice, however, many of the Concurrent List of functions were pre-empted by the Federal Government, including the following:

- Population Planning and Social Welfare
- Environmental Pollution and Ecology
- Welfare of labor, provident funds, old age pensions, etc.

- Trade unions; industrial and labor disputes
- Electricity
- Curriculum Development
- Zakat and Auqaf
- Others

An indication of the extent of centralization of revenue collection and of public expenditure is given in Table 3.1.

Table 3.1
Share of Different Levels of Government
(%)

	Share of	
	Federal Government	Provincial Governments
Revenue Collection		
1979-80	88	12
1989-90	90	10
1999-2000	89	11
2009-10	88	12
Expenditure		
1979-80	80	20
1989-90	77	23
1999-2000	76	24
2009-10	72	28

Source: SBP

Provincial Governments accounted for 12 percent of the total revenue collection and for 28 percent of public expenditure in 2009-10. These shares are much lower than in India (also a Federation). The States in India have a share in revenue collection of 30 percent and in expenditure of 35 percent.

Following the return to democracy in 2008, there have been some important moves towards decentralization and shifting the locus of power from Islamabad to the Provincial capitals. First, the 18^{th} Amendment increased the fiscal powers of the Provinces by the transfer especially of the sales tax on services. Second, this Amendment also abolished the Concurrent List and transferred the functions in this List fully to the Provinces. Third, the 7th NFC Award transferred more resources to provinces by raising the share in the divisible pool from 50 percent to 57.5 percent. By 2012-13, the combined share of the four Provincial Governments in revenues had increased in expenditure to over 30 percent.

But as they say, 'the Empire strikes back'. The tendency towards centralization once again has been promoted especially by the Federal bureaucracy. Some of the Concurrent list functions have been either retained or duplicated on the grounds of the need for 'co-ordination'. The present PML-N government has more of a 'centralist' mind set than its predecessor, the PPP. Consequently, tensions have increased between the Federal Government and the Governments of Sindh and Khyber Pakhtunkhwa. Both these Governments have other political parties in power.

3.2. Vested Interests / 'Sacred Cows'

The real political economy in fiscal policy is visible in the role played by vested interests and the presence of 'scared cows'. Historically, the ultimate 'sacred cow' has been the military establishment. The defense budget was traditionally presented as a lone-line item and not subject to any discussion in the Parliament. Following some pressure for a modicum of accountability, the defense budget of Rs 700 billion ($7 billion) has become a six-line item. Needless to say, the argument is that transparency has to be sacrificed on the grounds of security.

Then there is the category of 'charged expenditure', as per Article 81 of the Constitution. Charged expenditure cannot be voted upon by the National Assembly. These charged expenditures cover the budgetary provisions for the following:

- National Assembly
- Senate
- President's Staff and Allowances
- Audit
- Supreme Court
- Islamabad High Court

- Electricity
- Wafaqi Mohtasib
- Federal Tax Ombudsman

The above charged expenditure adds up to Rs 10 billion. In addition, servicing and repayment of debt is also in the nature of charged expenditure. It is interesting that the cost of Prime Minister's Office is not in the nature of charged expenditure and has to be voted upon.

Turning to special tax treatment in terms of access to exemptions and concessions as well other benefits/privileges, there are a number of powerful vested interests who actively engage in rent-seeking behavior and thereby achieve a degree of state capture in Pakistan. Some prime examples of such vested interests are listed below:

- The Military
- The Feudal class
- The Trading Community
- Exporters (especially APTMA)
- Multinational Companies
- Independent Power Producers (IPPs)
- Commercial Banks
- Urban Property Owners
- VIPs and Parliamentarians
- Capital Market / Stock Exchange
- Public Sector Enterprises (PSEs)
- Residents with Foreign Income

The types of benefits enjoyed are listed in Chart 3.1.

In effect, the tax system of Pakistan is like a 'sieve', with hundreds of holes. Some of these tax benefits are incorporated in SROs. Others are even embodied in the tax law (like the Second Schedule in the Income Tax Ordinance). The cost of the exemptions and concessions is quantified in Chapter 4. These are often referred to as 'tax expenditures'.

Chart 3.1
Types of Benefits Pre-empted by Various Groups in Pakistan

A. FUEDAL CLASS	
(1)	Extremely Low income taxation
(2)	Lack of Indexation of Land Revenue
(3)	Very Low rates of *Abiana* and disproportionate allocation of water
(4)	Subsidy on Imported Fertilizer
(5)	High Procurement Price of Wheat (in relation to import parity price)
(6)	Lower Tax Rate on Tractors
(7)	Effectively Low Stamp Duty on Land Transactions
(8)	'Tax Loophole' of Agricultural Income
(9)	Low Electricity Charges on Tubewells
(10)	No Petroleum Levy on LDO
B. MILITARY	
(1)	Little or no Parliamentary scrutiny of defense budget
(2)	Tax Privileges of Senior Officers
(3)	No GST on Defense Stores
(4)	Exemption of Business Income of Foundation / Trust
(5)	Lower or no Property Tax collected from Cantonment Boards
(6)	Access to Plots
C. TRADING COMMUNITY	
(1)	Low PIT, high evasion and low collection
(2)	Exemption from GST (minor move now)
D. EXPORTERS (ESPECIALLY APTMA)	
(1)	Low PIT on Export Receipts
(2)	Exemption of Domestic Sales from GST or very low rates
(3)	Zero duty on imported cotton (5% recently)
(4)	SROs for low duties on imported inputs
E. MNCs	
(1)	Relatively high tariff walls for import substitution e.g. Automotive Sector
(2)	Now lower CIT on FDI (20 percent vs 33 percent)
(3)	SROs for cheaper inputs, especially, pharmaceuticals and chemicals
(4)	No Law on Transfer Pricing
F. POWER SECTOR	
(1)	Lifetime exemption from CIT of IPPs
(2)	Big TDS and Retirement of Circular Debt

Chart 3.1 Types of Benefits Pre-empted by Various Groups in Pakistan	
G. BANKS	
(1)	Tax rate down from 58 percent to 35 percent, despite large spreads
(2)	Tax Deductibility for Provisioning against Bad Debt
(3)	Under Capitalization
(4)	No Withholding Tax on Interest Income
	(Contd...)

(...Contd.) Chart 3.1 Types of Benefits Pre-empted by Various Groups in Pakistan	
H. URBAN PROPERTY OWNERS	
(1)	Very low rates of UIPT due to under assessment of GARVs
(2)	Low Income Tax on Rental Income
(3)	No Taxation of Long Term Capital Gains
(4)	Low Rates of Stamp Duty / CVT due to outdated Valuation Lists
(5)	Non-extension of Rating Areas to benefit Developers
I. VIPs*	
(1)	Tax exemption of Perquisites
(2)	Access to Subsidized Land in Posh Societies
(3)	Duty Free Imports
Parliamentarians	
(1)	Low Rate of Filing of Returns
(2)	Development Fund Allocations for Constituencies(suspended currently)
Foreign Income of rich Residents	
(1)	Effectively not taxed even if generated in countries with which Pakistan has ADT agreements
J. CAPITAL MARKET / STOCK EXCHANGE	
(1)	No or very low Taxation of Capital Gains
(2)	No Questions asked on source of investment
K. PUBLIC SECTOR ENTERPRISES	
(1)	High tariff Protection (e.g. Iron and Steel)
(2)	Underwriting of Losses

(...Contd.) Chart 3.1 Types of Benefits Pre-empted by Various Groups in Pakistan	
(3)	Conversion of Debt into Equity (WAPDA)
(4)	Access to Government Guarantees on Borrowing (PSO)
L. SENIOR BUREAUCRATS	
(1)	Low Rate of taxation on Monetization of Transport
(2)	Large and Rapid Salary Increases and Pensions
(3)	Exemption on Large Pensions and Provident Funds
(4)	Exemption on Behbood Certificates after retirement
(5)	Access to Subsidised Plots in Islamabad
*includes President, Prime Minister, Ministers, Supreme Court Judges, Chiefs of the Army, Navy and Air Force and Core Commanders.	

3.3. Beneficiaries of Subsidies

Like tax benefits, many 'subsidies' which impose a cost on either the Federal and Provincial exchequers are 'hidden' in character and not visible to the people at large.

Perhaps the most dramatic example of hidden subsidy is in irrigation. This benefits disproportionately more the large farmer. Irrigation charges (*abiana*) recover only a minor part of the cost (amortization plus O&M costs). According to SPDC (2002), *abiana* covers only 9 percent of the total cost. The value of this subsidy is about Rs 150 billion ($1.5 billion) currently. Not only is this a high cost but also the low level of irrigation charges has promoted wasteful use of water at a time when Pakistan has already become a 'water-stressed' country.

The second subsidy which is not visible is on roads and highways. The amortization and recurrent costs of this network is estimated at almost Rs 120 billion (1.2 billion). But very few highways have toll charges and those that do, the charges are nominal. The solitary exception is the Islamabad – Lahore Motorway. Here again, SPDC estimates the subsidy at almost 95 percent of the cost. A progressive toll policy would be to charge relatively more from private vehicles.

The third example is of public higher education. According to Article 25A of the Constitution, education, up to the secondary level, is to be provided by the State. But this need not be the case with college and university education. However, public universities and colleges charge very low fees. Recent estimates are that the net subsidy to these institutions is in the region of Rs 100 billion ($1billion). A more appropriate policy would be to charge higher fees coupled with merit-and need-based scholarships. But this system is difficult to administer and students represent a vocal minority which will resist any such move. It must also be recognized that public universities have played a major role in promoting upward social mobility in the country.

Turning to subsidies which are explicitly highlighted in budget documents the largest subsidy currently being provide is the tariff differential subsidy (TDS) to the power sector. This aggregated to over Rs 300 billion in 2013-14. Life-line consumers (with consumption less than 200 kwh per month) are charged a very low tariff of Rs 2 per kwh, which is less than 12 percent of the cost.

There are two serious problems with the TDS. While it must be recognized that it is major positive step by the Government to keep a high subsidy for the relatively poor, domestic consumers, the number of such consumers has become artificially inflated in collusion with staff of the distribution companies. According to one estimate, almost 60 percent of domestic consumers of electricity are life-line consumers.

This implies that almost half the TDS goes to life-line consumers. The second problem is that beyond the life-line tariff, the tariff structure is very progressive in character and rises from Rs 2 to Rs 18 per kwh. While this imposes a higher price on large consumers it has created strong incentives for collusion and for evasion.

The other large subsidy is the food subsidy provided by both the Federal and Provincial Governments. It is incurred in the process of procurement of wheat and supply to the flour mills. The revealed amount of this subsidy is Rs 40 billion for the country as a whole. But there is a large hidden part, involved especially in the interest cost of commodity financing.

The basic problem with the wheat subsidy, like other subsidies, is that it is a generalized subsidy and not targeted towards the poor. Proposals for better targeting of this subsidy are also given in Chapter 8.

Other relatively small subsidies are those on imported fertilizer and to the Utility Stores Corporation. The former benefits more the large farmer who uses more fertilizer per acre, while the latter is of greater benefit to poorer households.

Overall, the basic issue of the political economy of subsidies is that a large part benefits the richer segments of society. In the presence of generalized subsidies, powerful interests are likely to thwart moves towards better targeted subsidies.

3.4. Choice of Projects / Programs

The return to democracy has inevitably led to 'constituency politics'. This was manifest during the PPP Government in the form of the Peoples Works Program (PWP). Under this program, MNAs/Senators were given allocations of funds for spending on projects in their respective constituencies. There was some scope for leakages out of these funds for personal benefit. At its peak, the size of the PWP was Rs 27 billion.

Beyond the PWP, the Prime Minister and the Federal Ministers each had discretionary funds which could be used as desired without the due process of approval. Provincial governments also had provisions for funding of MPAs constituency projects. In addition, the Provincial ADPs had block grants which could be used at the discretion of the Chief Minister.

In a ruling the Supreme Court has banned the practice of discretionary funds and allocation of funds at the constituency level. The objectives are to restore a degree of accountability and to prevent a situation where members of the opposition are discriminated against.

The PML-N government has found another way of gaining political mileage through the launching of populist programs. The most often quoted scheme is the distribution of thousands of laptops among youth. In addition, under the banner of *Prime Ministers Schemes*; the following schemes have been launched recently:

- PM's Interest Free Loan Scheme
- PM's Business Loan Scheme
- PM's Fee Reimbursement Scheme for Less Developed Areas
- PM's Youth Training Scheme
- PM's Youth Skill Development Scheme
- PM's Housing Scheme

These schemes essentially reflect and extend the earlier announced Youth Program. The combined allocation for these schemes is Rs 21 billion in 2014-15. The Provincial Government of Punjab is also running similar schemes like the Yellow Cab Scheme.

The large Benazir Income Support Program is discussed in the chapter on Social Protection. The new found predilection towards 'mega projects' is highlighted in the Chapter on Development Priorities.

3.5. Role of the Legislature

The role of the Parliament in fiscal matters is specified in the following articles of the Constitution:

73	Procedure with respect to the Money Bill
74	Federal Government's consent required for financial measures
77	Tax to be levied by law only
80	Annual Budget Statement
81	Expenditure charged upon federal Consolidated Fund
84	Supplementary and excess grants
88	Finance Committees

One of the most important fiduciary functions of the Legislature is to pass the Money Bill, before the start of any financial year (July to June). This Bill consists primarily of the Finance Bill, which contains all the taxation proposals for the coming year. A copy of the Money Bill is also sent to the Senate for recommendations on any changes. However, these changes are not mandatory on the Government.

According to Article 78, all revenues received by the Federal Government, all loans raised shall form part of the Federal Consolidated Fund (FCF). All other money shall be credited to the Public Account of the Federation.

Along with the Finance Bill, the Federal Government shall place before the National Assembly a statement, the Annual Budget Statement (BAS), of estimated receipts and expenditure for the forthcoming financial year and the revised estimates for the previous year. The proposed expenditure, excluding the charged expenditure, shall be submitted in the form of demands for grants and the National Assembly shall have the power to assent to or refuse to assent to any demand, or to assent subject to reduction of the amount. A description of the budgetary process is given in Annexure 1.

Similar provisions exist with regard to the approval of the Finance Bill and the Annual Budget at the provincial level by the Provincial Assembly. The difference is that there is no equivalent of the Senate in a Provincial legislature.

The Constitution, no doubt, provides for the due process of passage of the Annual Budget, along with the Finance Bill. But, in practice, the discussion on expenditure priorities and on the taxation proposals is not of a very high quality. Members are generally not familiar with the technical aspects of the budget or taxation. The quality of the debate in the Senate is somewhat higher.

3.6. Role of the Judiciary

The Supreme Court is the apex court of Pakistan. Among other functions it has the role of ensuring that provisions of the Constitution are strictly adhered to in fiscal matters. Some examples of judgments, given below, highlight the role of the Supreme Court. The Supreme Court also has suo-moto power.

i) CRP NO1 / 2014, dated 14- May-2014

Judgment that no discretionary fund shall be granted to either the Prime Minister or a Minister. Also no funds shall be expended on any scheme at the behest of any MNA or MPA.

ii) SUO MOTO CASE NO 18 OF 2010

Action regarding violation of PPRA, 2004, by NICL.

iii) CONSTITUTION PETITION NO 35 OF 2013

Action on the multi-billion scam in EOBI.

iv) CONSTITUTION PETITION NO 33 & 34 OF 2013

Action on the multi-billion scam in EOBI.

Therefore, one of the positive developments in recent years is the growing independence of the Judiciary, one of the pillars of the State. This, as indicated above, has put greater pressure for accountability of the Executive. Suo-moto powers have enabled the Supreme Court to take action against mega scams and acts of corruption.

CHAPTER 4

THE TAXATION SYSTEM OF PAKISTAN

The first three Chapters have provided the setting for identifying in specific terms the contours of progressive fiscal policy. Chapter 1 highlighted the articles of the Constitution of Pakistan which define the fundamental rights of the people and the principles of policy. Chapter 2 identified the existing deficits in inclusive growth, removal of which constitutes the principal challenge for progressive fiscal policy. Chapter 3 then presented the political economy considerations in the formulation of fiscal policy presently, most of which could act as impediments to making this policy more progressive in character.

An important caveat is in order here. Progressive fiscal policy will focus on equity both in taxation and in benefits from public expenditure. However, it needs to be emphasized that while the technical elements of such a policy can be described in depth, the basic issue is the feasibility of implementation of such a policy in the existing political milieu. as highlighted in Chapter 2, the State has been effectively captured by the elite. How then will policies be adopted which lead to inclusive growth and benefit the people at large, especially in the lower strata?

We have no answers to the feasibility question. But we still have faith that the 'rough and tumble' of democracy will eventually lead to broader political representation and enable the conduct of progressive fiscal policy. Already, there are signs of popular demands for changes in the system. Meanwhile, as a blueprint for the future we proceed to highlight the potential elements of a progressive fiscal policy.

This chapter and the next Chapter deal with progressive tax policy. Thereafter, the subsequent chapters focus on the expenditure side of fiscal policy.

This Chapter describes the taxation system of Pakistan, both Federal and Provincial. Section 4.1 identifies the trend in the overall tax-to-GDP ratio and the contribution of individual taxes. Section 4.2 makes some international comparisons. Section 4.3 highlights the sectoral distribution of taxes and Section 4.4 gives the incidence of the tax burden by income level. The Chapter concludes with a quantification of tax expenditure.

4.1. Tax-to-GDP Ratio

The overall tax-to-GDP ratio, inclusive of Federal and Provincial taxes, surcharges and levies, was 9.6 percent in 2012-13, as shown in Table 4.1. During the last two decades the tax-to-GDP ratio has shown a declining tendency, falling from a peak of 13.8 percent in 1995-96. However, it has risen by almost 0.5 percent of the GDP in 2013-14.

A positive development is the rise in the share of direct taxes. Over the last decade, direct taxes have increased from 28 percent to over 35 percent of total tax revenues. This has contributed to a more balanced and progressive tax system. The significant fall is in indirect taxes from 6.9 percent to 6.1 percent of the GDP, between 2000-01 and 2013-14. However, there continues to be greater reliance on indirect taxes, especially on taxes on goods and services. This suggests that the major focus of tax reforms in the country will have to be on further enhancing the share of direct taxes, as highlighted earlier.

Table 4.1

Tax-to-GDP ratio of Pakistan, 2000/01–2012/13

(% of GDP)

Year	Direct Taxes	Indirect Taxes	Surcharge/ Levy	Total Taxes	Share of Direct Taxes
2000-01	2.99	6.89	0.73	10.61	28.18
2001-02	3.20	6.41	1.23	10.83	29.54
2002-03	3.17	6.94	1.41	11.53	27.49
2003-04	2.92	6.84	1.09	10.84	26.94
2004-05	2.72	7.01	0.41	10.14	26.82
2005-06	2.82	7.06	0.67	10.54	26.75
2006-07	3.85	6.41	0.74	11.00	35.00
2007-08	3.79	6.47	0.34	10.60	35.75
2008-09	3.46	6.00	0.99	10.44	33.14
2009-10	3.66	5.83	0.90	10.39	35.23
2010-11	3.31	5.64	0.63	9.58	34.55
2011-12	3.58	6.06	0.40	10.04	35.65
2012-13	3.20	5.92	0.48	9.60	33.33
2013-14	3.38	6.09	0.43	10.09	35.46

Source: Ministry of Finance, GOP

The structure of tax revenues is shown in Table 4.1. The highest contributor to the public exchequer is sales tax followed by direct taxes on income and profits. A transition took place in Pakistan following trade liberalization starting from the mid-90s whereby the revenue contribution of taxes on trade declined. Over the last decade, the share of customs duties has declined from 14 percent to 10 percent. The decline in the overall tax-to-GDP ratio is, in part, attributable to Pakistan's inability to fully compensate for the revenue loss due to the process of trade liberalization.

Table 4.2
Share of Revenues from Different Taxes
(Rs in Billion)

	2007-08	Share (%)	2012-13	Share (%)
Federal	1024.7	96.2	2383.0	93.1
Direct Taxes	387.7	36.4	891.0	33.4
Indirect Taxes	637.7	59.8	1384.0	59.7
Excise Duty	86.5	8.1	138.0	5.4
Sales Tax	385.5	36.2	1005.0	38.2
Customs Duties	150.5	14.1	241.0	10.9
Petroleum Levy and Others	14.5	1.4	108.0	5.2
Provincial	40.2	3.8	180.0	6.9
Stamp Duties	11.3	1.1	n.a.	n.a.
MVT[b]	7.8	0.7		
Property Tax	4.1	0.4		
Others[c]	17.0	1.6		
Total	1064.9	100.0	2563.0	100.0

[a]Gas Development Surcharge | [b]Motor Vehicles Tax | [c]Including land revenue, agriculture income tax, electricity duty and the sales tax on services
Source: Fiscal Operations, MOF

Over 93 percent of taxes are generated by the federal government with the provincial contribution being only about 7 percent. The share of the latter, however, has been on the rise recently, particularly in the aftermath of the 7th National Finance Commission (NFC) award which devolved sales tax on services to the provinces.

4.2. International Comparisons

Comparing Pakistan's tax indicators with selected countries in the region, leads to a number of conclusions. First, Table 4.3 demonstrates that Pakistan has the lowest tax-to-GDP ratio among 13 selected developing countries. The average tax-to-GDP ratio of the 13 countries is 14.5 percent as compared to under 10 percent for Pakistan, implying that, Pakistanis', in a manner of speaking, are under taxed to the tune of 3-4 percent of the GDP compared to the other nationals in selected countries.

Table 4.3
Comparison of the tax-to-GDP ratio and the taxation structure in selected countries

Country	Year	Tax to GDP Ratio (%)[a]	Share (%) of taxes on		
			Profits, Income	Goods and Services	International Trade
Bangladesh	2011	10.0	26.7	36.9	36.6
Brazil	2010	15.3	43.4	52.9	3.7
China	2009	10.5	28.2	67.5	4.2
India	2010	15.7	34.9	55.5	9.6
Indonesia	2010	10.9	53.7	43.4	2.9
Malaysia	2010	13.8	77.7	19.5	2.8
Pakistan	2011	9.3	34.6	52.7	12.7
Philippines	2011	12.3	47.6	30.3	22.1
South Africa	2010	26.0	56.5	39.5	4.0
Sri Lanka	2011	12.4	21.8	56.4	21.8
Thailand	2011	17.6	46.4	48.2	5.4
Turkey	2010	20.6	31.4	67.0	1.6
Egypt	2010	14.1	48.5	42.3	9.2
Average (13 Countries)	**2009 to 2011**	**14.5**	**41.9**	**47.2**	**10.9**

Source: Pasha (2013)

Second, the share of direct taxes is 35 percent in Pakistan while the average for the 13 countries is over 42 percent. Clearly our earlier conclusion of the need of moving the tax structure towards direct taxes is substantiated. Third, the significance of trade related taxes in Pakistan is in line with the average for the region. However, the share of taxation of goods and services is more than the regional average.

4.3. Sectoral Distribution

An important element in the taxation system is also how these are collected from different sectors of the economy. The nominal incidence of taxes indicates the sectors which pay the tax. Box 4.1 presents the sectorial distribution of taxes. Nine taxes are levied on industry including corporate income tax, customs duties, withholding taxes, sales tax, excise duties, petroleum levy, motor vehicle tax and gas development surcharge. The most number of taxes are collected from industry. At the other extreme is the agricultural sector which pays the withholding tax on crops, customs duties on agricultural items, presumptive income tax on agricultural exports and agricultural income tax, land revenue and a share of stamp duties.

Box 4.1
Sectorial Incidence of Taxes

Services Sector
Sales Tax of Services
Federal Sales Tax
Excise Duty on Services
Corporate Income Tax on Services
Withholding Tax on Services
Share in other Withholding Taxes
Custom Duty on Freight and Insurance on Import Goods
Urban Immovable Property Tax
Industry
Corporate Income Tax on Industry
Customs Duties on Manufacturers
Withholding Taxes Share
Sales Taxes on Goods
Excise Duties on Manufacturing
Petroleum Duty
Motor Vehicle Tax
Gas Development Tax
Urban Immovable Property Tax
Agriculture
Withholding Tax on Agricultural Crops,
Custom Duties on Agricultural Item,
Presumptive Income Tax on Agricultural Exports
Agricultural Income Tax, Land Revenue and Stamp Duties.

Services sector which accounts for over half of the economy and is the most rapidly increasing sector bears the burden of seven taxes: provincial sales tax of services; federal sales tax (on certain services like restaurants and franchises), excise duties; corporate income tax; withholding tax; customs duty on freight and insurance, and; infrastructure development fee on freight levied by Sindh government. The important question which arises is what is the revenue contribution of each sector to the public exchequer?

Quantification of the nominal incidence indicates that the spread of tax burden on the three sectors is very skewed, as shown in Table 4.4. Over 76 percent of tax revenues are collected from the industrial sector. This is a very high share when compared to the other sectors. Services sector contributes 21 percent to revenue collection and agriculture less than 3 percent. Clearly taxation policy in Pakistan needs to more balanced sectorally and effort needs to be made to tap more the services and agricultural sectors more.

Table 4.4
National Sectoral Tax Incidence, 2011-12
(Rs. In Billion)

	Tax Revenue	% of Tax Revenue
Industry	1567.6	76.4
Agriculture	54.9	2.6
Services	430.4	21.0
Total	**2052.9**	**100.0**

Source: Estimated

4.4. Incidence of Taxes

Equity considerations relating to horizontal and vertical equity require that the tax system is designed such that there should be "equal treatment of equals" and those who have the ability to pay more should pay more taxes than those who don't. This is one of the cardinal principles of progressive fiscal policy. As such, there is need to derive explicitly the implications of the tax system on who bears the burden of taxes in Pakistan? This has been derived for the year 2007-08 by Wahid and Wallace [2010] as part of a study commissioned by FBR. The pattern of incidence is given in Table 4.5, according to which the burden appears to be mildly progressive, despite the many tax expenditures on the richer segments of society.

However, there are reasons to believe that the tax burden has become less progressive since 2007-08. First, the incidence of indirect taxes on the lower income deciles has increased because of the change in the contribution of different commodities to revenues. In particular, the share of revenues collected from POL products has risen from 19 percent in 2007-08 to over 32 percent by 2013-14. Bulk of the revenues accrues from HSD oil which is used primarily for public transportation.

Table 4.5
Incidence of Taxes in Pakistan, 2007-08

Deciles	Taxes Paid as % of Income		
	Direct Taxes	Indirect Taxes	Total taxes
1	2.01	6.42	8.43
2	2.20	6.17	8.37
3	2.18	6.08	8.26
4	2.30	6.20	8.50
5	2.35	6.59	8.94
6	2.38	6.73	9.11
7	2.50	6.26	8.76
8	2.91	6.82	9.73
9	3.35	6.28	9.63
10	6.38	6.74	13.12

Source: FBR, Quarterly Review, April-June 2010

Second, the incidence of withholding taxes, especially on imports, contracts, electricity and telephones, is likely to be more regressive than allowed for in the methodology used by Wahid and Wallace [2010]. In fact, Kemal [2008] demonstrated that the overall incidence of taxes was regressive in 1999-2000. More recently, IPP [2012] has calculated the burden of indirect taxes by quintile in 2008-09. The results indicate that the incidence is more regressive than indicated by the FBR study. Overall, the incidence of taxes in Pakistan is not progressive.

4.5. Tax Expenditure

Tax expenditure is the revenue foregone due to exemptions and concessions, which are deviations from a normal tax regime. There is a strong perception that one of the major reasons for the low tax-to-GDP ratio in Pakistan is the high level of tax expenditure, some of which been highlighted earlier.

The Pakistan Economic Survey has a special chapter on federal tax expenditure. The reported magnitudes for 2013-14 are presented in Table 4.6.

Table 4.6
Estimate of Tax Expenditure According to World Bank and Pakistan Economic Survey 2011-12 SUMMARY
(Rs in Billion)

Tax	2012-13 World Bank Estimated	Percentage of GDP	2013-14 Pakistan Economic Survey Estimates	Percentage of GDP
Income Tax	126.0	0.60	96.6	0.38
Company	53.9	0.26	n.a.	
Individual/AOP	20.1	0.10		
Withholding	52.0	0.25		
Sales Tax	148.0	0.70	249.0	0.98
Import	58.4	0.28		
Domestic	89.6	0.43		
Customs	128.1	0.61	131.5	0.52
Total	402.0	1.91	477.1	1.88

Source: Estimated.

According to the PES, the total expenditure is Rs 477 billion, in 2013-14, equivalent to 1.9 percent of the GDP. The major share, 52 percent, is in sales tax, followed by customs duty with a share of 28 percent.

The World Bank [2013] estimates for 2012-13 aggregate to just over Rs 400 billion, equivalent also to 1.9 percent of the GDP. The tax expenditure appears to be, more or less, equally distributed between income tax, sales tax and customs duty.

Estimates of tax expenditure have been prepared for the study. These include the revenue foregone due to exemptions or concessions embodied in the tax laws and in the SROs. These estimates are presented in Table 4.7.

The total national (federal and provincial) tax expenditure is estimated at Rs 872 billion in 2012-13, equivalent to 3.7 percent of GDP. The federal component is 2.6 percent of the GDP, and the provincial component, 1.1 percent. The largest share in tax expenditure at the federal level is in income tax of almost 1.2 percent of the GDP. These results are significantly different from the above findings. First, the level of tax expenditure is visibly higher, especially with the inclusion of provincial taxes. Second, the share of direct taxes is much larger.

Table 4.7
Estimated Federal and Provincial Tax Expenditures
(Tax Base of 2012-13)

	Tax Expenditures *(Rs in Billion)*	Percentage of GDP
Federal	576	2.56
Income tax	264	1.17
Sales tax	167	0.74
Customs duty	145	0.65
Provincial	256	1.14
Agricultural Income Tax	57	0.25
Land Revenue	10	0.04
Urban Immoveable Property Tax	54	0.24
Stamp Duty	12	0.05
CVT on Property	8	0.03
Sales Tax on Services	115	0.51
Total	872	3.70

Source: Estimated

Table 4.8
Estimated Tax Expenditure in Income Tax
(Tax Base of 2011-12)

No.	Description	Estimated Tax Expenditure (*Billion Rs*)
A.	Exemptions	102
1.	Tax Holiday (Life Time) to Independent Power Producers	53
2.	Under recovery of Capital Gains on Securities	29
3.	Exemption to Profit from Behbood Savings Certificates and Pensioners' Benefit Account	11
4.	Exemption of Income of Certain Trusts, Welfare Organizations, etc.	6
5.	Exemption of Profit from Euro/Sukuk Bonds	3
B.	Tax Deductions/Allowances	115
1.	Accelerated (Initial) Depreciation Allowance	64
2.	Investment Allowance to Personal Tax payers	9
3.	Tax Deduction on Provisioning by Banks	24
4.	Tax Deduction on WWF & WPPF Payments	11
5.	Tax Credit on Pension Fund/Provident Fund Contributions	4
6.	Tax Deduction on Charitable Contributions	3
C.	Concessionary Tax Rates	34
1.	Concessionary Rate on Sales Tax	5
2.	Concessionary Rate on Export of Services	3
3.	Concessionary Rate on Export of Goods	16
4.	Concessionary Rate on Supplies	3
5.	Concessionary Rate on Teachers	2
6.	Concessionary Rate on Dividends	5
D.	Others	13
1.	Other regional/sector/enterprise exemptions	13
	Total Tax Expenditure	264
	Percentage of GDP	1.17

Source: Estimated

The major tax expenditures in federal income tax are identified in Table 4.8. The 'big ticket' items are as follows:

- Accelerated Initial Depreciation Allowance
- Tax holiday (lifetime) to IPPs
- Under-recovery of Capital Gains on Securities

- Tax deduction on provisioning by banks

Overall, a progressive fiscal policy will have to focus particularly on removal of tax expenditures in income tax which benefit corporate entities and large personal tax payers.

4.6. Tax Evasion

The extent of tax evasion is difficult to quantify precisely because it is an unobserved phenomenon. Various estimates, based largely on casual empiricism, have been mentioned, ranging from 2 to 4 percent of the GDP.

There is, no doubt, some indirect evidence that supports the contention that tax evasion is rampant in Pakistan. In particular, the recently published tax directory by FBR has come up with some major findings as follows:

(i) The total number of tax payers who filed returns is only 791,123. The corresponding number for India is 32 million. Given the relative size of the two countries, the number in Pakistan should be about 3.5 million. In fact, earlier on NADRA had detected that there should be 3 million filers of returns. In fact, the number of individual taxpayers has fallen in the last six years.

(ii) The share of revenue from company returns is 73 percent and the remainder from individuals / AOPs of 27 percent. Interestingly, the share of revenues from companies is low in relation to other countries.

(iii) One of the most surprising statistics is that 45 percent of companies declared zero tax liability in their returns. Further, less than half the companies registered with SECP actually filed returns.

The analysis of the Tax Directory leads to a counter-intuitive conclusion. There is probably more revenue to be gained by focusing on tax evasion by companies. This, of course, must be accompanied by efforts for widening of the tax net to increase the number of individual tax payers.

CHAPTER 5

PROGRESSIVE TAX POLICY

Based on the previous chapters, the objectives of progressive tax policy are clear. First, the emphasis has to be on raising the direct tax-to-GDP ratio and increasing its share in total tax revenues. Second, both federal and provincial direct taxes need to be developed. Third, wherever possible, the burden of regressive direct and indirect taxes should be reduced. Fourth, implementation of progressive tax policy should not only lead to a more equitable tax system but also to a higher overall tax-to-GDP ratio of the country.

The Chapter is organized as follows: Section 5.1 deals with major reforms in the federal income tax and Section 5.2 with provincial direct taxes. Section 5.3 focuses on the rationalization of direct taxes, especially at the federal level.

5.1. Federal Income Tax

As described in the previous chapter, tax expenditures in the federal income tax aggregate to as much as Rs 264 billion. Progressive tax policy implies, first, the elimination of many of those tax expenditures, which primarily benefit corporate entities and persons with large incomes.

5.1.1. Elimination of Tax Expenditures

The following tax expenditures are proposed for elimination:

(i) Reduction in the first year depreciation allowance to companies from 25 percent to 15 percent.

(ii) Limitation of tax deductibility on loan provisioning by banks against bad debt only to SMEs and small farmers (below 12.5 acres).

(iii) Taxation of business income (if above 50 percent of total income) of trusts and foundations.

In addition there is a case for introduction of an inheritance tax to reduce wealth disparities over generations.

(iv) Taxation of foreign income of residents (citizens) in Pakistan accruing in countries where Pakistan has an Avoidance of Double Taxation and Fiscal Evasion agreement.

(v) Introduction of a Corporate Assets Tax at the rate of 0.25 percent initially as a special levy to finance part of the on-going costs of Internally Displaced Persons (IDPs).

(vi) Taxation of large pensions above Rs 1 million per annum.

5.1.2. Move from Scheduler to Comprehensive Income Taxation

Unearned capital incomes are generally taxed presumptively as separate blocs of income. This includes the following:

	PIT rate (%)
Dividends	10
Interest Income from Banks	10
Interest Income from National Saving Schemes	10

The proposal is to convert the PIT into a withholding tax so that tax payers are obliged to include this income in their returns. This will significantly enhance the progressivity of the tax system. Currently, even individuals with low incomes are subject to the PIT. This is patently unfair.

5.1.3. Development of Capital Gains Tax

Revenues currently are marginal from capital gains tax either on shares / securities or on property. The ITO provides for taxation only for capital gains accruing within a period of the first two years. The proposal is to set up a system (like in India) of taxation of realized real capital gains at any time, both on shares and properties. In addition, a withholding tax is proposed, called the *Transactions Tax*, at the rate of 0.5 percent of the reported value, in lieu of the capital gains.

5.1.4. Rationalization of Tax Rates and Schedules

The present tax structure is given below:

				(Rs in Million)
Type of Tax Payer	**Exemption Limit**	**Number of Slabs**	**Maximum Tax Rate**	**Taxable Income at which maximum rate applies**
Individual / Salaried	0.4	11	30	7
AOPs / Self-employed	0.4	7	35	6
Individual Company	-	-	33	-

The proposed reform will involve the reduction in the number of slabs for AOPs and individuals to five, to make the tax structure more progressive. To benefit especially the small tax payer, the exemption limit may be indexed to inflation every two years.

5.1.5. Reduction in Regressive Withholding Taxes

The Government has adopted the policy of raising withholding/ presumptive tax rates, even in case where the effective incidence is likely to be regressive. These include the following:

	WHT RATE (%)		Suggested Rate(%)
	2012-13	2013-14	2
Supplies	3½	3½ - 4	2
Importers	4	5 – 5½	4
Contracts	6	6%	4
Telephone Charges	10	15	5
Electricity		5-10	5
Services	6	607	4
Cable TV Operators	-	0.9 million	1
Transport Services	2	2	1

It needs to be emphasized that withholding /presumptive taxes are essentially in the nature of advance taxes. The objective should be to detect transactions and not to tax punitively without determination of the underlying taxable income. The consequence will be less filing of income with returns and more claims for refunds.

The overdevelopment of the withholding / presumptive tax regime in Pakistan is beginning to become counter– productive and more regressive in nature. Currently these taxes now account for almost 70 percent of total income tax revenue. Five years ago, the share was less than 60 percent.

5.1.6. Measures to Reduce Tax Evasion

During 2013-14, FBR made attempts, under also some IMF pressure, to send notices to persons with NTN who have not been filing returns. Unfortunately, this scheme has been an abysmal failure. In the Budget of 2014-15, a new approach has been adopted whereby withholding / presumptive tax rates have been enhanced generally for non-compliant tax payers. It remains to be seen whether this new strategy will work, as in many cases (e.g. bank transactions) it will impose high transaction costs on withholding agents in distinguishing between compliant and non-compliant tax payers.

The abdication of collection responsibilities by FBR is an unfortunate development. It is essential that the field staff of IRS use its existing power to detect tax evaders. For example, Section 114 of the ITO specifies nine types of persons who are required to furnish a return of income for a tax year. This includes persons who own urban property with a land area of 250 square years (10 marlas) or a flat having covered area of 2000 sq. feet or more, located in a rating area. The obvious strategy should be for PRAL to obtain the list of such property owners from the Provincial Excise and Taxation departments, which collect the urban immoveable property tax.

An extreme solution that has sometimes been suggested is to apply the law of pre-eminent domain on property transactions, whereby the tax authority has the right to buy a property at, say 10 percent above the declared price. Given the quality of the tax machinery in Pakistan today this move is not recommended. Instead, it may be made mandatory for the above types of property owners to furnish the last three year income tax payment certificate at the time of sale of a property.

Many of the proposals made above are radical in nature and unlikely to find favour with the present power structure in the country. However, they constitute a vital part of progressive fiscal policy.

5.2. Provincial Direct Taxes

5.2.1. Agricultural Income Tax

Perhaps the most commonly perceived inequity in the tax system is the substantial under-taxation of agricultural income in the country. The total AIT revenue from the four provinces is less than Rs 1 billion out of a total income of over Rs 6000 billion.

There are two reasons for the massive under-collection. First, the effective tax rates are very, very low and the penalty for not filing a return to BOR is a large amount of Rs 1000!

Second, given the political influence of the land owning class, the field level of functionaries of BOR are reluctant to send out notices to landowners above the exemption limit (of 12.5 acres).

A stage has been reached where the perception of inequity has led to a fall in compliance levels among tax payers with non-agricultural income. Therefore, one of the first tasks of a progressive fiscal policy must be tax effectively agricultural incomes, as follows:

(i) <u>Enhancement in PIT rates</u>

The proposal is as follows:

Acres of irrigated Land*	PIT Rs *(per acre)*		
	Present	Proposed (on the total land holding)	Effective Rate** (% of net income)
0 – 12½	Nil	Nil	Nil
12½ – 25	150	500	1.0
25 – 50	250	750	1.5
50 – 100	250	1000	2.0
100 – 150	250	1500	3.0

* 1 = acre of irrigated land ; 2 = acres of unirrigated land | **net income of Rs 50000 per acre

(ii) Under, the law, the option also exists for filing a return. The tax to be paid is the higher amount arising from the two systems.

(iii) The penalty should be 100 percent of the tax assessed under the PIT system in the event of failure to file a return.

5.2.2. Urban Immoveable Property Tax

This is effectively a Provincial tax on rental incomes. The tax is levied generally at the rate of 20 percent on the assessed Gross Annual Rental Value (GARV). According to Aisha Pasha (2012) the GARVs are less than 20 percent of the current market rental values in most parts of the country. Further, rating areas have not been adjusted in line with the expansion in metropolitan boundaries. In some cities, GARVs have not been reassessed since the late 80s or early 90s.

Therefore, development of the property tax will require the following:

(i) continuation of the existing exemptions

(ii) reassessment of GARVs

(iii) greater focus on commercial and industrial properties

(iv) decline in rebate for owner-occupied properties with size of property.

(v) computerization of records and eventual shifting to a self-assessment regime on prescribed form.

Unfortunately, the UIPT is becoming the urban equivalent of the AIT. Provincial governments are generally reluctant to raise revenues from this tax. In many countries, it is the main source of financing the provision of municipal services.

5.3. Indirect Taxes

There are two big issues with regard to indirect taxes. First, they are generally regressive in character and, second, in an effort to generate more revenues quickly, Governments have opted for raising indirect tax rates. For example, the standard rate of the GST has been raised from 12½ percent to 17 percent. According to ESCAP (2013) Pakistan has the highest rate of sales tax among Asian development countries, with the exception of Turkey.

The key elements of progressive fiscal policy on indirect taxes are discussed below.

5.3.1. Customs Duties

Progressive rounds of trade liberalization over the last two decades have led to a big reduction in import tariffs. The maximum tariff was brought down to 25 percent but raised subsequently in recent years to 35 percent. Today, there are seven slabs of tariff ranging from 0 percent to 35 percent.

The problem of declining protection to domestic import-substituting industry has been managed by the promulgation of SROs, with concessionary rates of duty or exemptions or raw materials, intermediate goods, sub-components, components and machinery. There has been a greatly deal of rent-seeking behavior around these SROs and resulting revenue losses of up to Rs 131 billion.

Fortunately, under pressure especially from the IMF, the Government is committed to eliminate these SROs in a three-year time frame. Some initial steps have been taken by the Government in the Budget of 2014-15.

Which are the industries which benefit most from import duty SROs? This is given in Table 5.1 below.

Table 5.1
Tax Expenditure on Import Duty SROs by Industry, 2013-14
(Rs in Billion)

Chapter of Harmonized Code	Description	Tax Expenditure
87	Vehicles and part thereof	36
27	Mineral fuels	15
85	Electrical Machinery and Equipment	13
84	Machinery & Mechanical Appliances	13
29	Organic Chemicals	8
72	Iron and Steel	6
23	Prepared Animal Feed	5
73	Articles of Iron and Steel	5
Others		31
TOTAL		132

The largest beneficiary of SROs is the automotive sector, accounting for over 27 percent of the tax expenditure. It will be interesting to see how the Japanese manufacturers, who dominate this industry, will react to the withdrawal of concessions.

The other big group is machinery. It is essential that the domestic engineering industry be provided a modicum of protection by levying an import tariff of 5 percent on machinery, rather than allow import at zero duty.

A progressive fiscal policy on import duties ought to follow a 'big bang' approach. Import tariffs should be cascaded down in one go and most of the concessionary SROs withdrawn at the same time. This will not only minimize any negative impact on domestic industry, but also make the tariff structure much simpler and more transparent.

The proposed change in the import tariff structure is as follows:

Statutory Rate of Duty		
Slabs of Duty (%)	**Proposed (%)**	**Change (%)**
0	0	0
5	5[a]	0
10	5	-5
15	5	-10
20	15[b]	-5
25	15	-10
30	25[c]	-5
35	25	-10

[a] 5% on raw materials and machinery | [b] 15% on semi-finished goods | [c] 25% of finished goods

Concessionary SROs on essential items, especially food, should continue. This is a big and complex proposal. In the event of any tariff anamolies emerging, a special committee may be appointed to remove them.

5.3.2. General Sales Tax

Most of the SROs in the GST relate to import sales tax. The chapters which benefit most from the SROs are listed below in Table 5.2.

Table 5.2

Tax Expenditure on SROs in Import Sales Tax, 2013-14

(Rs in Billion)

Chapter of Harmonized Code	Description	Tax Expenditure
27	Mineral fuels	61
99	Special classification	33
15	Vegetable Oils	25
85	Electrical Machinery	22
29	Organic Chemicals	14
84	Machinery and Mechanical Appliances	13
52	Cotton	13
72	Iron and Steel	7
89	Ships, boats	6
54	Man-made filaments	6
Others		49
TOTAL		249

The policy on import sales tax SROs ought to be as follows:

(i) The SROs should continue on essential items

(ii) A new reduced tax rate of 5 percent may be used to cover inputs into export-oriented industries like textiles, e.g., Chapters 52 and 54. Also, import of machinery in Chapters 84 and 85 may also be subject to the 5 percent sales tax.

(iii) The standard GST rate may be applied on other Chapters.

Following the above broad-basing of the GST, the standard rate should be brought down to 15 percent from 17 percent, with the eventual target of 12½ percent. This will benefit the lower income households.

In addition, excise duty may be levied on activities which confer negative externalities, in the form of noise, pollution, etc. There is a list of Dangerous and Offensive trades which could be brought under the ambit of the excise duty. As opposed to this, direct and indirect tax incentives should be provided for investments in renewable and clean energy.

5.3.3. Provincial Sales Tax on Services

This tax was transferred to the Provinces in the 18th Amendment. The Provinces have made major attempts to develop this tax by setting up specialized tax agencies, SRB and PRA. This is consistent with the goals of progressive fiscal policy, because, first, services are under taxed presently and, second, consumption of services is relatively more by the upper income groups.

Proposals that could be implemented to raise more revenues include the following:

(i) Taxation of imported services, under the 'reverse charge' principle.

(ii) Taxation of services provided by different types of consultants, travel agents, and car dealers (via companies).

(iii) A low non-invoiceable tax rate of 4 percent on rental services by commercial and industrial property; private educational institutions (charging fees above Rs 50000 per annum) and private hospitals.

(iv) Introduction of a withholding sales tax of 4 percent at the time of payment for services received by government entities and companies.

(v) Make a transition within the next three years from the positive list of taxable services to a negative list.

Following the implementation of the above proposals, the standard rate should be brought down from 16 percent to 15 percent, with the eventual target of 12½ percent.

5.3.4. The Petroleum Levy

This is a flat levy per litre on selected petroleum products by the Federal Government on two products – motor spirit and HSD oil. It generates significant revenues of almost Rs

100 billion annually. The consumption of motor spirit is progressive in character, while HSD is used for the transportation of goods, and is likely to impose a regressive burden.

It is suggested that the flat rate structure be changed to make the levy more progressive, as shown below:

Petroleum Levy		
	(Rs per litre) Present	Proposed
• High Octane	14	20
• Motor Spirit	10	14
• HSD	8	4
• LDO	–	4
• Kerosene Oil	–	–

Overall, readers of this Chapter may be inclined to conclude that the above set of proposals in Federal and Provincial Taxes essentially constitute a 'wish list', which is highly unlikely to be implemented given the 'political economy' of tax policy today. But it is important to highlight the key elements of progressive fiscal policy, to show how far we are from the 'ideal'. Of course, if implemented, the above package has the potential of raising the tax-to-GDP ratio by up to 2 percent of the GDP.

The revenue impact of different taxation proposals is given in Table 5.3. Out of the total package of Rs 500 billion, the share of revenue from direct taxes, both federal and provincial, is 50 percent. This will increase the share of such taxes in total tax revenue.

Table 5.3

Revenue Impact of Progressive Taxation Proposals

(2013-14 Tax Base)	Revenue Import (Rs in Billion)
FEDERAL DIRECT TAX	**200**
• Withdrawal of Tax Expenditure	70
• Move from Schedular to Comprehensive Income	20
• Taxation of Capital Gains	50
• Measures to reduce tax evasion	100
(Companies)	(75)
(AOPs / Individuals)	(25)
• Reduction in Regressive Withholding Taxes	-60
• Others	20
IMPORT DUTIES	**50**
IMPORT SALES TAX	**150**
PROVINCIAL	**100**
AIT	30
UIPT	20
Provincial Sales Tax on Services	50
TOTAL	
% of GDP	2

Source: Derive by author

CHAPTER 6

MANAGING CURRENT EXPENDITURE

This Chapter focuses on the component of current expenditure in the budgets of Federal and Provincial Governments. Section 6.1 describes the aggregate trends in this type of expenditure. This is followed by a discussion on the cost of debt servicing in Section 6.2, on security-related expenditures in Section 6.3, on social services in Section 6.4, on subsidies in Section 6.5, on grants in Section 6.6 and on costs of administration in Section 6.6.

6.1. Trends in Current Expenditure

The trends in current expenditure are given in Table 6.1.

Table 6.1

Trends in Current Expenditure, 2008-09 to 2013-14

Indicator	Unit	2008-09[a]	2010-11[b]	2013-14
Total Current Expenditure	**% of GDP**	**16.0**	**16.5**	**16.6**
Federal		11.7	11.9	11.6
Provincial		4.3	4.6	5.0
Share of Provincial Governments	**%**	**26.9**	**27.9**	**30.1**
Share of Current Expenditure in Public Expenditure	**%**	**80.4**	**84.2**	**76.9**
Federal		83.0	87.5	78.9
Provincial		74.1	76.7	72.4
Total Current Expenditure as % of Revenue Receipts	**%**	**107.4**	**126.2**	**101.4**

[a]first year of PPP government | [b]first year after 7th NFC Award

Source: MOF, Fiscal Operations.

The table indicates the following:

(i) Current expenditure as % of GDP has shown a modest rising tendency from 2008-09 onwards.

(ii) Following the 7th NFC Award, the share of provincial governments has increased. It crossed 30 percent in 2013-14. This indicates a gradual process of fiscal decentralization.

(iii) The share of current expenditure in total expenditure shows a mixed trend. It has been rising for the Federal government, indicating some 'crowding out' of development expenditure. As opposed to this, the Provinces have been able to reduce the share of current expenditure in their respective budgets.

(iv) Current expenditure has generally exceeded total revenue receipts, implying a revenue deficit in the consolidated budget of the Federal and Provincial Governments. The improvement in 2013-14 is due to large 'gift' from a friendly country.

Overall, it appears that current expenditure is consuming more than the available resources, and development expenditure has been constrained to a low level in order to limit the size of the fiscal deficit. This has had major implications on the growth process in the economy and led to the emergence of large infrastructure deficits.

A progressive fiscal policy will aim to reduce the share of current expenditure and ensure that there is no revenue deficit. As such, the proposed targets over the next three years are as follows:

(i) Containment of total expenditure to 15.5 percent of GDP

(ii) Increase in development expenditure to 6 percent of the GDP

(iii) Increase in total revenue receipts to at least 15.5 percent of the GDP

6.2. Cost of Debt Servicing

The cost of debt servicing is given in Table 6.2. The major development is the big increase of almost 67 percent between 2010-11 and 2013-14, equivalent a rise of 0.8 percent of the GDP. This explosion is due primarily to a phenomenal jump in domestic debt of Rs 4870 billion, an increase of 105 percent. Consequently, even though the effective interest rate has fallen significantly, the debt servicing cost has increased by almost Rs 480 billion in three years.

The increase is expected to moderate somewhat to Rs 138 billion in 2014-15. This is the consequence of the decline in fiscal deficit from 8 percent or more of the GDP in 2011-12 and 2012-13 to less than 6 percent of the GDP in 2013-14.

Table 6.2

Cost of Debt Servicing, 2008-09 to 2013-14

	Unit	2008-09	2010-11	2013-14	2014-15 (P)
Interest of Payments[a]	***Rs in Billion***	**630.0**	**708.0**	**1187.3**	**1325.2**
on Domestic Debt	"	558.6	653.6	1108.8	1224.6
on External Debt	"	71.7	74.4	78.5	100.6
Interest of Payments[a]	***% of GDP***	**4.8**	**4.0**	**4.7**	**4.6**
on Domestic Debt	"	4.2	3.6	4.4	4.2
on External Debt	"	0.6	0.4	0.3	0.4
Outstanding Debt[b]	***Rs in Billion***		**8409.9**	**14000.4**	**15909.5**
Domestic Debt	"		4650.8	9520.9	11019.0
External Debt	"		3759.1	4479.5	4890.5
Outstanding Debt[b]	***% of GDP***		**56.6**	**62.2**	**62.6**
Domestic Debt	"		31.3	42.3	43.4
External Debt	"		25.3	19.9	19.2
Interest Payments as % of Outstanding Debt	***%***		**8.4**	**8.5**	**8.3**
Domestic Debt	"		14.0	11.6	11.1
External Debt	"		2.0	1.8	2.0

[a] by the Federal Government | [b] of the Federal Government, lagged by one year

Source: MOF, Fiscal Operations.

The Implications for progressive fiscal policy are as follows:

(i) The consolidated fiscal deficit must be controlled to below 6 percent of the GDP. This is below the target for 2014-15, although IPR [2014] projects that it will approach 7 percent of the GDP.

(ii) The mix of outstanding debt has changed sharply in favor of domestic debt, from 55.3 percent to 69.3 percent in three years. in the absence of large currency depreciation, domestic debt tends to be more expensive than borrowing externally from traditional sources, like the multilateral agencies. The implication is that while low cost external debt should be preferred, reliance on high cost external debt, like the Eurobonds, should be avoided.

(iii) Within domestic debt, the composition (MTBs vs PIBs) should be a function of the outlook for interest rates. If these are expected to rise than PIBs should be preferred. As opposed to this, if they are anticipated to fall, then the choice should be in favor of MTBs. In 2013-14, PIBs have been the primary form of domestic borrowing.

6.3. Security-Related Expenditures

Security-related expenditures not only include the defense budget but also the cost of quasi-military forces and the expenditure on police (primarily by provincial governments). Estimates of security-related expenditure are given for recent years in Table 6.3.

Table 6.3

National Security-Related Expenditure

by the Federal and Provincial Governments

2012-13 to 2014-15

(Rs in Billion)

Head	2012-13	2013-14	2014-15 (P)
FEDERAL	**820.1**	**901.8**	**1007.8**
Defense (Military) Services	570.4	629.8	700.1
Police	66.0	71.4	79.8
Airport Security Force	3.0	3.6	4.3
Civil Armed Forces	29.1	32.4	36.0
Frontier Constabulary	6.2	6.2	7.0
Pakistan Coast Guards	1.4	1.5	1.6
Pakistan Rangers	12.6	14.5	15.6

Military Pensions	131.4	142.4	163.4
PROVINCIAL	145.3	161.2	179.0
Law and Order (Police, etc.)	145.3	161.2	179.0
TOTAL	**965.4**	**1063.0 (10.1)***	**1186.8 (11.6)***
% of GDP	4.8	4.7	4.1

* growth rate

Source :Annual Budget Statements

These are much larger than generally perceived. In fact, they are 43 percent more than the defense budget alone. In 2014-15, total security-related expenditure is expected to cross Rs 1 trillion ($10 billion), second only to interest payments on debt. In fact, these two heads consume virtually the entire net revenue receipts of the Federal Government. All other expenditures have to be financed through borrowing.

According to the ABS of 2014-15, security related expenditure is expected to fall from 4.7 percent of the GDP in 2013-14 to 4.1 percent in 2014-15. This is very unlikely. Pakistan is engaged in a war in the FATA region. Consequently, costs of military operations will be significantly higher.

In addition, there is the cost of one million IDPs. It has already been suggested in Chapter 5 that there should be a temporary levy of the Corporate Assets Tax. In addition, an IDP surcharge was levied on large individual tax payers in 2010-11.

The high level of security-related expenditure of 4.7 percent of the GDP in 2013-14 demonstrates the high cost that Pakistan has had to incur to counter militancy and terrorism, as well as the insurgency in Balochistan and the bad law and order situation in Karachi. This is almost 150 percent of the total public expenditure on education and health.

It is hoped that if the Army is able to establish the writ of the state in FATA and clean up terrorist cells in the rest of the country that this expenditure can be brought down eventually to the level in the 90s of less than 3.5 percent of the GDP.

6.4. Expenditure on Social Services

We turn now to the public expenditure on social services. Following the 18th Amendment a large part of this expenditure is incurred by the Provincial governments, as shown in Table 6.4.

Table 6.4
Public Expenditure* on Social Services
2008-09 to 2012-13

(Rs in Billion)

	2008-09	2010-11	2012-13
EDUCATION	240.4	322.3	479.8
Federal	44.4	59.8	71.7
Provincial	196.0	262.5	408.1
HEALTH	83.7	106.0	161.2
Federal	16.8	22.8	11.4
Provincial	66.9	83.2	149.8
WATER SUPPLY AND SANITATION	22.2	28.5	34.0
Federal	0.1	0.6	1.9
Provincial	22.1	27.9	32.1
TOTAL	346.3	456.8	675.0
Federal	61.3	83.2	85.0
Provincial	285.0	373.6	590.0
AS % OF GDP			
Expenditure on:			
Education	1.8	1.8	2.1
Health	0.6	0.6	0.7
WSS	0.2	0.2	0.2
Total	2.6	2.6	3.0
SHARE OF PROVINCIAL GOVERNMENTS (%)	82.2	81.8	87.4

* both current and development expenditure
Source: PRSP progress reports

Public expenditure on different social services is low in Pakistan. In 2012-13, expenditure on education exceeded 2 percent of the GDP, perhaps for the first time. Expenditure on health is only one-third of the expenditure on education. Combined expenditure on social services approached 3 percent of the GDP in 2012-13. This represents a share of only 15 percent of total public expenditure.

Clearly, the objective of progressive fiscal policy must be to raise the level of expenditure on social services. In their manifestos all major political parties have set ambitious targets for such expenditure. But in the presence of high cost of servicing debt and security-related expenditure this has not been possible. A realistic target is to increase the public expenditure on social services by 1 percent of the GDP in the next three years.

The expenditure priorities within education are shown in Table 6.5. There appears to case for increasing allocations for higher technical education, teacher and vocational training.

Table 6.5
Expenditure Priorities within Education
2012-13

(Rs in Billion)

Head	Expenditure	Share (%)
Primary	178.3	37.2
Secondary	138.5	28.9
Higher-General	82.6	17.2
Higher-Technical	23.5	4.9
Teacher and Vocational Training	10.5	2.2
Others	46.4	9.7
TOTAL	479.8	100.0

Source :PRSP reports

Within health, the expenditure priorities are highlighted in Table 6.6.

Table 6.6
Expenditure Priorities within Health
2012-13

Head	Expenditure	Share (%)
General Hospitals and Clinics	131.9	81.8
Mother and Child Health	0.3	0.2
Health Facilities and Preventive Measures	14.5	9.0
Others	14.5	9.0
TOTAL	161.2	100.0

Source: PRSP reports

This distribution of health expenditure is very imbalanced. There is a very strong political preference for constructing hospitals, which are visible to the public eye. The tragedy is the extremely low priority for preventive measures. This explains why polio and other diseases are still present in Pakistan. Over 10 percent of children aged 1 to 2 years have not been through a full course of inoculation. Provincial governments should start gender-responsive budgeting of social sector expenditures.

Within the target increase of 1 percent of the GDP in social services, half should go to health. Within the increase in allocation for health, half should be devoted to preventive measures and to mother and child clinics.

6.5. Subsidies

Bulk of the subsidies is financed by the Federal Government. As shown in Table 6.7, subsidies virtually trebled between 2008-09 and 2011-12, reaching the peak level of Rs 512 billion in 2011-12. Since then they have fallen by 37 percent to Rs 323 billion in 2013-14, equivalent to 1.3 percent of the GDP.

Table 6.7

Breakup of Subsidies* by Federal Government

(Rs in Billion)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Tariff Differential Subsidy	*111.6*	*179.5*	*343.1*	*464.2*	*349.3*	*309.4*
WAPDA	92.8	147.0	295.8	419.0	265.0	245.1
KESC	18.8	32.5	47.3	45.2	84.3	64.3
*ICP***	*26.6*	*30.0*	*171*	*18.2*	-	-
Utility Stores Corporation	*3.8*	*4.2*	*4.2*	*2.0*	*6.0*	*6.0*
Oil Refineries / OMCs	*70.0*	*11.2*	*10.8*	*7.9*	*1.2*	-
Import of Fertilizer	*31.7*	*10.0*[a]	*5.0*	-	-	-
TOTAL	**252.0**	**229.0**	**395.8**	**512.3**	**367.5**	**323.0**
Memo Item:						
Share of TDS (%)	*44.2*	*78.4*	*86.6*	*90.6*	*95.0*	*95.8*

* Excluding retirement of circular debt | ** for import of wheat and sugar

Source: Ministry of Finance, GOP

The increase in the subsidy bill is primarily attributable to the explosive growth in the tariff differential subsidy (TDS) to the power sector, which currently accounts for over 95 percent of the cost of subsidies. Cumulatively, since 2008-09, the TDS has aggregated to Rs 1757 billion!

One of the biggest challenges for the Federal Government is to reduce the TDS. If retirement of circular debt is added to the TDS then the total cost exceeds Rs 600 billion annually. In fact, the main reason why the fiscal deficit reached 8 percent of the GDP in 2012-13 was the retirement of accumulated circular debt of Rs 480 billion. Currently, the pending circular debt to be cleared is Rs 350 billion. However, no provisions have been made in the Budget of 2014-15 to take care of this liability.

It is clear that fiscal stabilization will not be achieved until the financial viability of the power sector is restored. The Government raised power tariffs substantially in the earlier part of the year in 2013-14, but the TDS remained above Rs 300 billion.

Tariff increases have not yielded the desired revenues because of serious structural problems and bad governance in the sector. Billing losses have increased sharply following the tariff increases. The fuel mix has implied higher generation costs due to reduced availability of gas. The Government has now accepted that it will take at least four years to restore viability of the sector and bring down load shedding to low levels.

6.6. Grants

There are a number of receipts of grants from the Federal Government. These include regional grants, grants to loss-making state utilities and public enterprises, etc. The break-up is given in Table 6.8.

Table 6.8

Grants by Federal Government

2012-13 to 2013-14

(Rs in Billion)

Recipient	2012-13	2013-14	2014-15 (B.E)
Special Grants to Provinces	61.2	53.8	24.2
Grants to AJ&K, Gilgit-Baltistan Governments	36.3	36.0	42.0
Subsidy to PSEs / Utilities	**35.4**	**33.5**	**37.0**
Pakistan Railways	33.4	33.5	37.0
Pakistan Steel Mill	2.0	-	-
Contingent Liabilities	150	150	190.0
Social Protection	6.0	4.4	4.4
Others	45.7	58.2	73.2
TOTAL	**334.6**	**335.9**	**370.8**

(B.E.) Budget Estimates

The largest head is contingent liabilities. These are presumably funds for unanticipated expenditures like losses of other PSEs, subventions for power sector, commodity financing. This is over 5 percent of total expenditure, and there is need for greater transparency and accountability of this expenditure.

Then there are special grants to the Provincial Governments. These should have been avoided after the generous 7th NFC Award. In 2014-15, these grants will be reduced by 55 percent, a step in the right direction. The governments of Azad Jammu and Kashmir and Gilgit-Baltistan also receive sizeable grants.

The Pakistan Railway has been running into substantial losses, requiring a bail-out from the Federal Government. Other PSEs receiving support are Pakistan Steel Mills, PIA, etc. The objective must be to either restructure these entities and/or privatize them.

6.7. Costs of Administration

The overhead costs of the Federal Government are given in Table 6.9. Contrary to expectations, these are accounting for an increasing share of current expenditure. The basic reason for this is the more than doubling of salaries and allowances in the last five years, due to large annual increases. For example, the increase granted in pay and pensions was 50 percent in 2010-11. Consequently, the costs of civil administration have been rising by almost 13 percent annually, significantly above the rate of inflation.

Table 6.9

Costs of Civil Administration of the Federal Government

(Rs in Billion)

	2010-11	2012-13	2013-14	2014-15 (B.E)
Pay and Allowances	92.6	251.2	148.4	193.3
Other Costs	114.7		122.9	113.0
Pensions	20.8	36.0	45.2	57.8
TOTAL	**226.1**	**287.2**	**316.5**	**364.1**
Share of Total Current Expenditure	**9.8**	**10.6**	**10.8**	**11.6**

(B.E.) Budget Estimates

Source: ABS

There is, no doubt, a case for increasing salaries of civil servants. But the policy should be to grant increases linked to the rate of inflation. While the previous government of PPP followed a very liberal policy of granting increases, the PML-N government has shown greater discipline. In the latest budget, the pay increase announced is 10 percent, somewhat above the rate of inflation of 8.6 percent.

The expectation was also that after the 18th Amendment the Federal Government would contract significantly, with the transfer of many functions to the Provincial Governments. But this has not happened. There are still 28 Ministries and 37 Divisions. The Federal Cabinet has 47 members.

Progressive fiscal policy would ensure the following:

(i)	**Contraction of Ministries / Divisions by almost 40 percent**	
	(a)	Merger of Aviation Division / Defense Division
	(b)	Merger of Economic Affairs Division / Planning Division
	(c)	Merger of Textile Industry Division and the Industries Division
	(d)	Merger of Defense Production and the Defense Division
	(e)	Merger of Housing and Works Division and the Capital Administration Division
	(f)	Merger of IT & Telecommunications Division and the Communications Division
	(g)	Merger of Overseas Pakistanis Division and the Foreign Affairs Division
	(h)	Merger of Petroleum and Natural Division and the Water and Power Division
	(i)	Merger of Railways Division and Communications Division
	(j)	Scientific & Technological Research Division with the Industries Division
	(k)	Merger of Kashmir Affairs and Gilgit-Baltistan Division with the States and Frontier Regions Division
	(l)	Merger of Ports and Shipping Division and Communications Division
(ii)	**Dissolution of the following Ministries which are still performing the transferred functions**	
	(a)	Ministry of Education and Training
	(b)	Ministry of National Health Services
	(c)	Ministry of National Food Security

In addition, a recruitment ban should be rigidly enforced over the next three years.

Turning to the Provincial Governments, their employment is almost three times that of the Federal Government (excluding the military). But bulk of the employment is in relatively low grades and engaged in the provision of labor-intensive services like education and health. Overhead costs are about 60 percent of the Federal Government, but the liability of pensions is rising rapidly.

Overall, Pakistan is caught is a quagmire. The high costs of debt servicing, security and subsidy to cover losses in the power sector imply that development expenditure on infrastructure and outlays on social services will continue to be 'crowded out'. This highlights the urgency for implementing progressive tax reforms to create more 'fiscal space' for priority expenditures and keep the fiscal deficit at below 6 percent of the GDP.

CHAPTER 7

MANAGING DEVELOPMENT SPENDING

Pakistan today suffers from a large 'infrastructure deficit', especially in power and water. The index of human development is growing very slowly because of underinvestment in the people. These are a reflection of low development spending, both at the Federal and Provincial Levels.

The first section of this Chapter highlights the low level of development expenditure and how this has been the first casualty in the process of fiscal stabilization. Section 2 presents the sectoral composition of PSDP / ADPs. Section 3 describes the existing portfolio of Federal projects and the 'mega projects' in the process of being executed. Section 4 discusses the components of the other so-called 'other development expenditure' and net lending by the Federal government.

7.1. Size of PSDP / ADPs

The size and distribution of development spending on projects/programs between the Federal and Provincial Governments is given in Table 7.1. In the last five years, the combined development spending has generally been below 4 percent of the GDP. This is in contrast to the peak period of development spending in the history of Pakistan. During the 80s, Pakistan used to allocate almost 8 percent of the GDP for public development spending.

Table 7.1
Level and Distribution of Development Spending

(Rs in Billion)

	2008-09	2012-13	2013-14	2014-15 (B.E)
PSDP	517.9	695.1	904.0	1225.8
Federal	259.5	323.5	425.0	525.0
Provincial	258.4	371.6	479.0	700.8
Share of Federal Government in PSDP (%)	50.1	46.5	47.0	42.8
Total PSDP as % of GDP	3.9	3.1	3.5	4.2

(B.E.) Budget Estimates
Source: MOF

Further, there are annually large cut backs, in an effort to reach fiscal deficit targets, especially during the tenure of IMF programs. For example, in the first year 2013-14, in the presence of the Extended Fund Facility of the IMF, the total development program has been reduced by Rs 252 billion in relation to the original budgetary estimates. This represents a cut back of 22 percent, as shown in Table 7.2.

Table 7.2
Cutback in the PSDPs
(Rs in Billion)

	Federal	Provincial	Total
2009-10			
Budget Estimate	441	200	641
Actual	310	200	510
% Cut back	*25.0*	*0.0*	*22.8*
2012-13			
Budget Estimate	360	513	873
Actual	388	463	851
% Cut back	*-7.8*[a]	*9.7*	*2.6*
2013-14			
Budget Estimate	540	615	1155
Actual	425	478	903
% Cut back	*21.3*	*22.3*	*22.0*

[a] Actual expenditure higher than bud

7.2. Sectoral Distribution

7.2.1. Federal

The sectoral distribution of the PSDP executed at the Federal level is given in Table 7.3 for 2012-13 and 2013-14. A change in priorities is visible in 2013-14, with the transition from a PPP to PML-N Government. The latter is more oriented towards infrastructure development. Consequently, the share of actual allocations to infrastructure has increased by 38.2 percent, as shown in Table 7.3.

In the proposed PSDP of 2014-15, the largest allocation is to the National Highways Authority of over Rs 111 billion. This is primarily to start work on the Lahore-Karachi Motorway. The next largest allocation is Rs 64 billion for WAPDA (power). Inclusive of allocations to PAEC and self-financing by WAPDA the total proposed investment in the power sector is over Rs 200 billion.

Table 7.3

Sectoral Distribution of the PSDP of the Federal Government

(Rs in Billion)

	2012-13	Share (%)	2013-14	Share (%)	2014-15 (B.E)	Share (%)
INFRASTRUCTURE	**221.3**	**57.0**	**305.9**	**72.0**	**131.1**	**59.6**
• Communications	0.1		0.2	-	0.2	-
• National Highways Authority	71.1		88.5	20.8	111.6	21.3
• Pakistan Atomic Energy Commission	44.0		52.3	12.3	51.5	9.8
• Ports and Shipping	0.3		6.3	1.5	2.6	0.5
• Railways	25.8		28.0	6.6	39.6	7.5
• Water and Power (Water)	45.3		54.0	12.7	43.4	8.3
• WAPDA (Power)	34.7		76.1	17.9	63.6	12.1
• Information Technology & Telecommunication	0.8		0.5	0.1	0.6	0.1
SOCIAL SERVICES	**47.7**	**12.3**	**52.5**	**12.3**	**63.1**	**12.0**
• Education and Training	2.9		3.2	0.7	3.5	0.7
• Higher Education Commission	15.6		22.5	5.3	20.1	3.8
• National Health Services	0.2		26.8	6.3	27.0	5.1
• MDGs Programme			-	-	12.5	2.4
• Finance Division	29.0			-	-	-
DIRECTLY PRODUCTIVE SECTORS	**2.9**		**4.7**	**1.1**	**4.3**	**0.8**
• Defence Production	0.5		0.5	0.1	0.9	0.2
• Industries	0.7		1.4	0.3	1.1	0.2
• National Food Security	0.3		0.5	0.1	1.1	0.2
• Science and Technology	1.2		2.0	0.5	0.9	0.2

• Textile Industry	0.2		0.3	0.1	0.3	–
GOVERNANCE	**6.1**		**26.7**	**6.3**	**5.0**	**1.0**
• Cabinet	1.9		24.7	5.8	2.0	0.4
• Inter-Provincial Coordination	2.7		0.4	0.1	0.4	0.1
• Law and Justice	1.2		1.3	0.3	2.4	0.4
• Revenue	0.3		0.3	0.1	0.2	–
REGIONAL			**46.5**	**10.9**	**76.5**	**14.5**
• Kashmir & Gilgit-Baltistan	19.4		23.0	5.4	21.4	4.1
• States and Frontier Regions	15.3		18.5	4.4	19.1	3.6
• Tameer-e-Pakistan	46.4[c]		5.0	1.1	–	–
• Province and Special Areas			–	–	36.0	6.9
OTHERS			**-11.3**	**-2.6**	**63.0[b]**	**12.0**
TOTAL	**388.4**		**425.0**	**100.0**	**525.0**	**100.0**

[a] Actual expenditure higher than budget

Other sectors with relatively high priority are Railways (Rs 39.6 billion), WAPDA for hydro-electricity (Rs 43.4) billion and Rs 27 billion for health. Two new programs are being initiated. The first program is a community based program for achieving the MDGs, while the second program is for development of backward areas in the country.

It remains to be seen how much of the PSDP of Rs 525 billion will be executed in 2014-15. The Government is committed to achieving a big reduction in fiscal deficit to less than 5 percent of the GDP.

7.2.2. Provincial

The proposed sectoral distribution of the ADPs of each Provincial Government in 2014-15 is given in Table 7.4. There is significant variation in priorities among the four provincial governments, as described below.

(i) The Punjab Government has allocated 43 percent of its ADP to development of infrastructure. The largest allocation in this category is for urban development, including the controversial Lahore Metro Transit project (costing $1.6 billion, with financing from China). Other Provinces have devoted about one fourth of their respective ADPs to infrastructure projects.

(ii) The highest priority to social sectors has been given by the Government of Khyber-Pakhtunkhwa, with a share of 43 percent. Within this allocation, almost 44 percent is for education. Other Provinces propose to devote 21 percent to 43 percent of their ADPs to social sectors.

(iii) A major new development is entry of Provincial Governments into the funding of energy projects, especially by Punjab and Sindh. This will support Federal efforts to remove the energy constraint.

(iv) A worrying development is the large allocation to special initiatives / programmes, especially by the Government of Sindh of over 19 percent. The details of such programs are not given and frequently represent funds to be spent at the discretion of the Chief Minister.

(v) The ADPs of Sindh and Khyber-Pakhtunkhwa are more decentralized than Punjab. The share of District Development Program is the highest in Sindh at 13 percent and the lowest in Punjab at 2 percent.

Table 7.4

Sectoral Priorities in Provincial ADPs

2014-15

(Rs in Billion)

Sector	PUNJAB		SINDH	
	Allocation	Share (%)	Allocation	Share (%)
INFRASTRUCTURE	**148.5**	**43.0**	**47.6**	**24.7**
Roads	31.6	9.2	14.2	7.4
Irrigation	30.6	8.9	12.9	6.7
Energy	31.0	9.0	20.5	10.6
Urban Development	42.4	12.3	-	-
Others	-	-	-	-
SOCIAL SECTORS	**119.4**	**34.6**	**55.7**	**28.9**
Education	48.3	14.0	15.0	7.8
Health	31.1	9.0	15.7	8.1
WSS	17.2	5.0	-	-
DD	7.5	2.2	25.0	13.0
Others	15.3	4.4	-	-
DIRECTLY PRODUCTIVE	**26.3**	**7.6**	**9.5**	**4.9**
Agriculture	8.0	2.3	7.2	3.7
Livestock	5.2	1.5	2.2	1.1
Industries	7.1	2.1	0.1	-
SPECIAL INITIATIVES/PROGRAMME	**33.0**	**9.6**	**43.0**	**22.3**
OTHES	**17.8**	**5.2**	**37.0**	**19.2**
TOTAL	**345.0**	**100.0**	**192.8**	**100.0**

Sector	K-PK		BALOCHISTAN	
	Allocation	Share (%)	Allocation	Share (%)
INFRASTRUCTURE	**36.4**	**26.0**		**53.9**
Roads	17.3	12.4		33.3
Irrigation	4.7	3.4		10.7
Energy	5.6	4.0		6.0
Urban Development	8.8	6.3		3.9
SOCIAL SECTORS	**60.1**	**43.0**		**21.3**
Education	26.1	18.7		6.0
Health	11.2	8.0		3.6
WSS	5.8	4.1		6.3
DDP	17.0	12.2		5.4
DIRECTLY PRODUCTIVE	**7.6**	**5.4**		**5.6**
Agriculture	2.5	1.8		
Livestock	-	-		
Industries	5.1	3.6		
SPECIAL INITIATIVES/PROGRAMME	**9.1**	**6.5**		
OTHERS	**26.6**	**19.0**		**19.2**
TOTAL	**139.8**	**100.0**		**100.0**

7.3. Portfolio of Projects

Table 7.5 gives the throw forward (remaining cost) and the cost of new projects included in the federal PSDP of 2014-15. The portfolio of projects has a total cost of Rs 7.76 trillion ($77.6 billion). New projects have added Rs3.54 trillion ($35.4 billion). In effect, the Federal Government has added 83 percent to the cost of the existing portfolio in one year. This is unprecedented.

The major sectors/agencies in the portfolio are Communications ($10.6 billion), including the China-Pakistan Economic Corridor (CPEC); Pakistan Atomic Energy Commission

($10.5 billion) for nuclear power; WAPDA for the power sector ($43.9 billion), including $32.5 billion for three major dams (Dasu, Daimer-Basha and Benji). In effect, 70 percent of the portfolio consists of projects in the power sector.

The disproportionately large size of the portfolio of $77.6 billion can be seen in relation to the PSDP in 2014-15 of $5.2 billion. This implies that on average a project will take almost fifteen years to complete! There is, therefore, no option but to prioritize the implementation of the portfolio, over the next four to five years.

A suggested prioritization is as follows:

(i) First priority to energy projects and associated infrastructure with relatively short gestation periods. These include the Karachi Coastal Project ($9.8 billion); Upgradation of Mangla ($0.5 billion); two coal-fired power plants at Jamshoro ($1.8 billion); there 750 MW CCPP in Punjab ($0.7 billion); coal fired plant at Lakhra ($0.9 billion); power evacuation from Gaddani to National Grid ($3 billion); Jetty and infrastructure at Gaddani ($0.7 billion) and initial funding of only one dam, the Dasu dam ($4.9 billion). The total cost of these projects in the power sector development program is $22.3 billion. This will require annual PSDP allocations for the power sector of over $5 billion, as compared to less than $2 billion currently. Much of the financing could come from China and the multi-lateral development banks. The federal PSDP would have to be increased by at least 1.2 percent of the GDP to create space for the power sector investments.

Table 7.5

Throw-forward of Federal On-Going Projects and Cost of New Projects

(Rs in Million)

	Division / Agency	Throw-forward as of 01.07.2014 [1]	Allocation 2014-15 to On-Going Projects [2]	Cost of New Projects [3]	Allocation 2014-15 to New Projects [4]	Size of Portfolio [1] + [3]	Total Allocation 2014-15
1.	Aviation	7286	196	14252	1205	21538	1401
2.	Cabinet	3528	1896	317	182	3845	2078
3.	CAD	1477	807	4175	999	5652	1806
4.	Climate Change	53	15	120	10	173	25
5.	Commerce	596	363	-	-	596	363
6.	*Communications*	*162555*	*54733*	*896708*	*57020*	*1059263*	*111752*
	Ministry	898	191	-	-	989	191
	NHA	161566	54542	150375	8020	311941	62556
	CPEC	-	-	746333	49000	746333	49000
7.	Defence	8910	2161	14175	100	23085	2261
8.	Defence Production	1624	937	-	-	1624	937
9.	EAD	100	5	-	-	100	5
10.	Education, Training	4918	1884	2637	1567	7555	3451
11.	Establishment	65	65	1000	100	1065	165
12.	Federal Tax Ombudsman	13	13	-	-	13	13
13.	Finance	56823	875	19571	2310	76394	11062

14.	Foreign Affairs	255	255	–	–	255	255
15.	HEC	68155	16793	50372	3275	118527	20068
16.	Housing & Works	11945	1824	185	110	12130	1934
17.	Industries & Production	24435	1048	1000	100	25435	1148
18.	Information	2286	384	200	40	2486	424
19.	IT & Telecommunications	2324	435	10450	121	12792	556
20.	Inter-Provincial Co-ord.	611	292	557	120	1168	412
21.	Interior	17665	2735	8273	1165	25938	3900
22.	*Kashmir & G-B*	*25419*	*20907*	*12004*	*450*	*37423*	*21357*
	Kashmir	8230	11727	7004	400	15234	12127
	Gilgit-Baltistan	17189	9180	5000	50	22189	9230
23.	Law	2391	1062	3937	1290	6328	2352
24.	Narcotics Control	1221	292	1770	32	2991	324
25.	Food Security	2810	740	2723	331	5533	1071

Table Continued

Table 7.5 *(…Continued)*

Throw-forward of Federal On-Going Projects and Cost of New Projects

(Rs in Million)

	Division / Agency	Throw-forward as of 01.07.2014 [1]	Allocation 2014-15 to On-Going Projects [2]	Cost of New Projects [3]	Allocation 2014-15 to New Projects [4]	Size of Portfolio [1] + [3]	Total Allocation 2014-15
26.	Health	115840	26814	1000	200	116840	27014
27.	PAEC	1049005	51043	3743	432	1052748	51475
28.	PNRA	659	200	700	30	1359	230
29.	Petroleum & NR	322	153	57	14	379	167
30.	P & D	2303	799	15446	2070	17749	2869
31.	P & D (Other)	-	-	30009	30009	30009	30009
32.	MDGs	-	-	25000	12500	25000	12500
33.	Special Fed Programme	-	-	36000	36000	36000	36000
34.	Ports & Shipping*	104	127	51663	2449	51767	2576
35.	Railways*	140979	31641	57818	7925	198797	39566
36.	Revenue	300	134	8522	18	8822	152
37.	Science and Technology	1497	561	2169	343	3666	904
38.	States and Frontier	-	-	19100	19100	19100	19100
39.	Statistics	926	220	279	20	1205	240
40.	SUPARCO	19570	700	-	-	19570	700
41.	Textile Industries	309	309	60	20	369	239

42.	*Water & Power (Power Sector)*	*2169819*	*175553*	*2222403*	*25027*	*4392222*	*200580*
	WAPDA (Hydel)	1651915	81227	1595320 **	200	3247235	81427
	Generation (GENCOs)	285895	22900	164087	500	449982	23400
	NTDC	177123	39924	435641	18867	612764	58791
	DISCOs	54886	31502	27355	5460	82241	36962
43.	Water and Power (Water)	304232	42554	21770	873	326002	43727
44.	ERRA	5000	5000	-	-	5000	5000
	TOTAL	**4218348**	**454402**	**3540165**	**207557**	**7758513**	**661959*** **

*including CPEC Projects

**Bunji Dam

***including self-financing by corporation

(ii) In the absence of adequate resources and the need to restrict the fiscal deficit to a maximum of 6 percent of the GDP it is proposed that other projects be deferred for implementation. In particular, the Lahore - Islamabad Motorway must receive much less priority than the power sector projects.

Overall, the 'spreading thin' of the PSDP must be avoided. This leads to substantial delays and large cost overruns. Within the available resources, water and power sector projects must have the highest priority.

Table 7.6

New Mega Projects*

(Rs in Billion)

Type**		Total Cost	Allocation 2014-15
H	China – Pak Economic Corridor (CPEC)	746.3	49.0
P	Karachi Coastal Power Project	958.7	12.1
R	Procurement of 150 D.E. Locomotives	55.5	-
P	Bunji Hydro Power Project (7100MW) – (Gilgit)	1595.3	-
P	Diamer- Basha Dam Project (4500MW)	894.0	25.0
P	Dasu Hydro Power Project (2160MW) – (K-PK)	486.0	4.4
P	Upgradation of Generation of Mangla (310MW)	52.2	1.3
P	Installation of New Coal Fired Power Plants at Jamshoro (2x660MW)	177.1	9.3
P	750MW CCPP at Shahdra, Multan and Faisalabad	75.0	-
P	Coal Fired Plant Lakhra (1x660)	88.6	-
P	Power Evacuation from Gaddani to National Grid	300.0	12.8
H	Jetty and Infrastructure at Gaddani (CPEC)	70.0	1.0
W	CRBC 1st Lift Cum Gravity Project, D.I. Khan	61.1	-
W	Raising of Mangla Dam Project (AJ&K)	96.9	-
	TOTAL OF ABOVE	**5656.7**	
	% OF PORTFOLIO	**73%**	

H = Highways I P = Power I R = Railway I W = Water

*Projects above Rs 50 billion in size on which less than 5 percent of the expenditure has been incurred.

Source: Planning Commission, PSDP, 2014-15.

7.4. Other Development Expenditure

The breakup of the other development is given in Table 7.7. This is a relatively new expenditure head. It was initially created to primarily accommodate the allocation to the Benazir Income Support Program (BISP). Since then, the expenditure on subsidizing imported fertilizer has been brought into this. In 2013-14, there was a large transfer once-off of Rs 157 billion to the Pakistan Development Fund (PDF) equivalent to the amount received as 'a gift' from a friendly country.

There has been some discussion as to whether this category of expenditure is really development expenditure. IMF classifies it as part of 'current' expenditure. The Government has preserved the classification of this expenditure as development expenditure because it understates the revenue deficit.

Table 7.7

Breakup of Other Development Expenditure

by the Federal Government

(Rs in Billion)

	2010-11	2013-14	2014-15 (B.E)
Benazir Income Support Program (BISP)	35.0	70.3	97.2
Grant for PPAF	3.0	14.5	7.7
Subsidy to TCP for Import of Fertilizer	-	30.0	25.0
Prime Minister's Schemes	-	-	21.0
Others	7.5	174.6*	10.9
TOTAL	**45.5**	**289.4**	**161.8**
Share of BISP (%)	**76.9**	**24.3**	**60.0**
% of GDP		**1.1**	**0.6**

*including transfer of Rs 157 billion to the Pakistan Development Fund.

Source:ABS

CHAPTER 8

SOCIAL PROTECTION PROGRAMS

In this Chapter, various types of social protection programs are described. Along with expenditures on basic social services, these programs represent the redistributive role of fiscal policy. Progressive fiscal policy requires that social protection programs/ schemes satisfy most of the following criteria.

8.1. Evaluation Criteria

(i) *Targeting efficiency:* measured by the extent to which a program's expenditure actually reaches poor people rather than the relatively well-off segments of the population. Programs which promote self-targeting by the poor are also ranked high on this criterion. For example, if the wage rate in a public works program is kept low enough to attract unemployed workers only and not divert workers from other jobs. Alternatively, provision of subsidy for a coarse or low quality food grain is likely to be availed only by relatively low income households.

(ii) *Extent of program coverage:* the proportion of poor households which receive benefits from the program;

(iii) *Degree of ease of access:* the level of transactions costs imposed on eligible households in accessing to the program, as indicated by the simplicity and transparency of procedures, documentation requirements and level of discretion with program officials in the disbursement of benefits. Programs with relative ease of access can be ranked 'high' on this criterion;

(iv) *Percentage of program expenditure dedicated to benefits:* measured by how much of the program budget is spent on benefits rather than on administrative costs;

(v) *Adequacy of support:* the extent to which the benefit reduces the poverty of a recipient;

(vi) *Income equivalence of transfer:* the extent to which the transfer is equivalent to a cash transfer and does not distort consumption choices of beneficiaries. For example, an open-ended subsidy on a good or service may lead to over-consumption and waste;

(vii) *Absence of negative incentive effects:* anti-poverty interventions can change behavior. For example, an unemployment benefit may reduce the motivation for job search. On the other hand, school food programs can raise school participation and reduce dropout rates;

(viii) *Extent of self finance / progressive financing:* programs which raise funding through well-defined and earmarked sources are likely to be more sustainable fiscally. A program is more secure if it is supported by higher income households rather than general budgetary sources which are vulnerable to inflation and cut-back when the fiscal position worsens as has happened in Pakistan during the last few years;

(ix) *Degree of independence from private transfers:* a transfer should ideally not displace corresponding transfers by households or private sector entities. An example of substitution is the *Zakat* whereby compulsory deductions may lead to a, more or less, matching reduction in private charitable contributions;

(x) *Degree of impact on development:* programs can contribute either directly or indirectly to development. A public works program, for example, could lead to the creation of improved irrigation or farm-to-market roads and thereby contribute to high agricultural productivity.

8.2. The Social Protection Programs

There are five types of social protection programs in Pakistan, as follows:

- Social security (pensions)
- Cash Assistance
- Price Subsidy
- Employment Programs
- Education and Training Programs

Social Security: Pensions are provided to civil and military personnel on fulfillment of some conditions. It is estimated that half the annual payment of pensions is made to relatively low level former employees.

The other major social security program is for workers in the form of the EOBI (see Box 8.1). There is also a Workers' Welfare Fund WWF (see Box 8.2).

Cash Assistance: The largest program is the Benazir Income Support Program (BISP), which today covers almost half the poor household in the country (see Box 8.3). The other programs like *Zakat* and *Baitul Maal* have a genesis in the religion but are relatively small.

Price Subsidy: The biggest mechanism of social protection in Pakistan today is the large subsidy to life-line consumers of electricity. This is costing as much as Rs 140 billion today. It is a big part of the TDS given to the power sector. There is a strong case for targeting this subsidy, as currently an inflated number of 17 million electric consumers are claiming this benefit.

The other major subsidy is the wheat price subsidy, given mostly by the Provincial governments. It is a generalized subsidy and should be made a more targeted subsidy. The Utility Stores Corporation (USC) has a chain of outlets in urban areas which sell food items like atta, sugar, ghee, etc., at prices lower than those prevailing in the market. But USC has only limited coverage, It is accessible to all income groups although quality is low and prone to leakages.

Employment Programs: These programs primarily involve the provision of micro-credit. The PPAF has the largest clientage, but still covers only 10 percent of the potential borrowers.

Education and Training Programs: Given the serious nature of the youth employment issue, the Federal Government has started under the PM's name a number of schemes. Provincial Governments, especially of Punjab, are also getting increasingly active in this area.

Perhaps contrary to expectations, the total outlay on social protection in Pakistan is quite large. It is estimated at Rs 439 billion in 2013-14, as shown in Chart 1, equivalent to 1.7 percent of the GDP. The largest share is of price subsidy (39.4 percent) followed by Social Security (29.4 percent) and Cash Assistance (17.5 percent.)

Table 8.1

Outlays on Different Social Protection Programs in Pakistan

(Rs in Billion)

Scheme	Benefits	Financing	Outlay (2013-14)
1. SOCIAL SECURITY			
• Civil / Ministry Pension Fund	• Pensions	• Federal and Provincial Budgets	115[a]
• Employees Old-Age Benefits Institution (EOBI)	• Old age Pension • Invalid Pension • Survivor's Pension for Workers	• Employer's Contribution • Employees Contribution	9
• Workers Welfare Fund	• Schools • Hospitals • Housing for Workers	• Employers' Contribution	5
		TOTAL	**129**
2. CASH ASSISTANCE			
• Benazir Income Support Program	• Cash Assistance	• Federal Budget	70
• Zakat	• Cash Assistance	• Deduction from Bank Deposits	5
• Baitul Maal	• Cash Assistance	• Federal Budget	2
		TOTAL	**77**

3. PRICE SUBSIDY			
• Subsidy to Life-Line Consumers of Electricity (Rs 2 / kwh)	• Lower Price of Electricity	• Federal Budget	140
• Subsidy on Procurement	• Lower Whet Price	• Federal Budget (PASSCO)	27
• Utility Stores Corporation (USC)	• Lower Price of Food Items	• Federal Budget	6
		TOTAL	**173**
4. EMPLOYMENT PROGRAMS			
• Pakistan Poverty Alleviation Fund (PPAF)	• Microcredit	• Federal Budget	15
• PM's Schemes	• Interest Free Loans • Business Loans	• Federal Budget	10
• Punjab Yellow Cab Scheme	• Subsidized Credit for Commercial Vehicles	• Provincial Budget	4
		TOTAL	**29**

(Continued...)

[a] 50 percent of the pensions are assumed to be received by low –level employees.

(...Continued)

Table 8.1

Outlays on Different Social Protection Programs in Pakistan

(Rs in Billion)

Scheme	Benefits	Financing	Outlay (2013-14)
5. EDUCATION AND TRAINING PROGRAMS			
• PMs Schemes: ○ Fee Reimbursement Scheme ○ Youth Training ○ Youth Skill Development ○ Laptop Scheme	• Subsidized Education and Training	• Federal Government Budget	11
• Punjab and Other Governments Schemes	• Subsidized Technical and Vocational Training	• Provincial Budgets	20
		TOTAL	**31**

S U M M A R Y

	(Rs in Billion)	(%)
1. Social Security	129	29.4
2. Cash Assistance	77	17.5
3. Price Subsidy	173	39.4
4. Employment Programs	29	6.6
5. Education and Training Programs	31	7.1
OVERALL TOTALS	439	100.0
%OF GDP	**1.7**	

Box 8.1

Employees Old Age Benefits Institution

The EOBI Act 1976 was designed to introduce pensions as per the Constitution. The Act covers all workers in establishments with five or more workers. Currently, over 67,500 establishments are actively registered with EOBI and the number of workers ensured is 5.7 million, while 485,000 are currently receiving pensions.

The EOBI is based on contributions from employers and employees and receives no subsidy from the Government. The employers' contribution is 5 percent of the minimum wage per worker while the employees' contribution is 1 percent.

Currently, there are four types of pensions: old age pension, invalidity pension, old age grant and survivor's pension. The minimum pension is Rs 3600 per month. The maximum pension is based on a formula.

According to the latest cash flow statement, of 2011, EOBI received Rs 9.2 billion as contributions and Rs 10.9 billion as investment income. Benefits paid to workers added up to Rs 9.4 billion. The overhead cost of EOBI was Rs 2.3 billion. The value of assets with EOBI is close to Rs 200 billion.

Proposals with regard to EOBI are as follows:

(i) The Government has raised the minimum wage recently to Rs 12000 per month. The EOBI has the financial resources to also raise its minimum pension.

(ii) EOBI has been racked by scandals with regard to its investments. The Board has to exercise more oversight.

(iii) The contributions should be linked not to the minimum wage but to the actual wages.

(iv) The EOBI schemes only cover workers in the formal sector. The self-employed could also be covered through an individual pass book system.

(v) Old age insurance was in the Concurrent List of the Constitution, which stands abolished after the 18th Amendment. Therefore, this function has to be transferred to the Provinces. This will require the allocation of assets of EOBI to the four Provincial Governments on the basis of some formula. This is a contentious issue.

(vi) The EOBI coverage should be extended to self-employed persons through a pass book system containing a record of their contribution at Rs 6000 per month (5 percent of minimum wage).

Box 8.2

Worker's Welfare Fund

The Workers Welfare Fund Ordinance, 1971, is the basis for the establishment of the WWF. It aims to provide workers with education and health facilities and low cost residential accommodation. Provincial Workers' Welfare Boards have been established and the Provincial ESSIs manage some of the projects.

The law is applicable to all establishments covered by the Shops and Establishments Ordinance, 1968. The FBR collects contributions from establishments at the rate of 2 percent of net income. In 2012-13, the total WWF collection was 4.5 billion.

The WWF also makes marriage/wedding grants and death grants.

Box 8.3

Benazir Income Support Program

The genesis of BISP is the sharp rise in food prices, especially of *atta*, in 2008-09. Initially, an allocation of Rs 34 billion was made to provide a cash supplement of Rs 1000 per month to poor families throughout Pakistan. The recipient is the adult female of a family.

Identification of beneficiaries is based on the 'Poverty Scorecard', a proxy means testing technique. Wherever possible the smart card system is being used to distribute the assistance on a quarterly basis.

A number of special initiatives have been introduced in the BISP. These include schemes for small loans, skill development, and support for catastrophic illness and for education of children of beneficiary families.

The BISP is funded entirely from the Federal Budget. The amount disbursed in 2013-14 was Rs 70 billion, which is being raised to Rs 97 billion in 2014-15. In line with inflation, the cash assistance per family has been raised from Rs 1200 to Rs 1500 per month. Over 5 million families are being covered by BISP. Almost half the poor in

Pakistan are benefiting from BISP.

In the Budget of 2013-14, the Government proposed an earmarked tax, the Income Support Levy, to provide funds especially for BISP. The levy was 0.5 percent of net moveable assets of a person. But the levy was challenged in the Courts and has been withdrawn in the Budget of 2014-15.

Proposals regarding BISP are as follows:

(i) BISP must be seen as the 'Flagship' social protection scheme of the Government, with focus primarily on cash assistance.

(ii) BISP should acquire the characteristics of a Conditional Cash Transfer (CCT) program. The basic support to families of Rs 1500 per month should be augmented for inoculation against polio and other diseases of the children in a recipient family and for sending the girl child to school. For this, cooperation must be sought from the Provincial Governments.

(iii) Efforts should be made to apply the Poverty Score Card periodically on recipient families to see if their conditions have improved to the extent that they can 'exit' from the Program.

8.3. Evaluation of Programs

Many of the programs mentioned in Chart 1 are evaluated on the ten criteria given in Section 8.1. The results are given in Chart 2.

The evaluation / rating formula is as follows:

(a) for an evaluation criteria

If rated	Score
High (H)	4
Medium (M)	2
Low (L)	0

(b) The maximum score is 40 and the minimum is zero

(c) All criteria have been equal weight.

The three programs / schemes with the highest scores are the following

		Score
1.	PPAF (Micro Credit)	28
2.	Government Pension Scheme	24
3.	BISP	24

The two programs / schemes with the lowest scores are the following

		Score
1.	Zakat / Baitul Maal	28
2.	Utility Stores Corporation	24

8.4. Proposals

Based on the principles of progressive fiscal policy, the following proposals are made regarding social protection programs:

(i) The BISP must be seen as the 'Flagship' program. It should be upgraded to a Conditional Cash Transfers (CCT) with implementation by cooperation with Provincial governments. Supplements should be given for inoculation and children and for sending the girl child to school. As more resources become available, the coverage of BISP should be expanded. There should also a monitoring system for 'exit' of households.

(ii) All generalized subsidies should be converted into targeted subsidies, especially the food (wheat) subsidy.

(iii) The price subsidy on electricity should be restricted to families who fall below a particular score in the Poverty Score Card and with an electricity connection. For other consumers, the tariff may be raised gradually from Rs 2 to Rs 4 per kwh, as the load shedding situation improves. Savings should be diverted to BISP.

(iv) The EOBI has sufficient financial resources. As such, within the next two years the minimum pension should be raised from Rs 3600 to 6000 per month. The latter is the minimum pension for government employees. Employers' contribution must be raised accordingly and linked to the actual wage bill.

(v) 'Social Welfare' has been transferred as a function to the Provincial Governments after the 18th Amendment. As such, the Federal Government should avoid launching new populist schemes. It is indeed unusual to see the Prime Minister of a country distributing laptops!

Chart 2

Evaluation of Programs

Criteria	BISP	Zakat/ Baitul – Maal	Govt. Pensions (low grades)	EOBI	Electricity Subsidy	Wheat Subsidy	USC	PPAF	PM's Schemes	Number of Schemes with H
• Targeting Efficiency	H	M	H	H	M	L	L	H	L	4
• Extent of Program Coverage	H	L	L	L	H	M	L	L	L	1
• Degree of Ease of Access	L	H	L	L	M	H	M	L	M	2
• Share of Benefit in Program Expenditure	M	M	H	M	M	L	L	M	L	1
• Income Equivalence of Program Benefits	H	H	H	H	M	M	M	H	H	6
• Absence of Negative • Incentive Effects	M	M	H	M	L	M	H	H	H	4
• Adequacy of Support	M	L	M	L	H	M	L	H	M	2
• Extent of Self/ Progressive Finance	M	H	M	H	L	M	M	M	M	2
• Degree of Independence from Private Transfers	H	L	H	H	H	H	H	H	H	8
• Degree of Impact on Development	L	L	L	L	L	H	L	H	M	2
SCORES	**24**	**10**	**24**	**20**	**20**	**22**	**14**	**28**	**20**	
High (H)	4	3	5	4	3	3	1	6	3	
Medium (M)	4	3	2	2	4	5	3	2	4	
Low (L)	2	4	3	4	3	2	5	2	3	

CHAPTER 9

MEDIUM-TERM BUDGET STRATEGY

This final chapter brings together the key elements of progressive fiscal policy, discussed the previous chapters, for inclusive growth into a medium-term budget strategy (MTBS).

Section 9.1 presents the MTBS of the Government for the period up to 2016-17. Section 9.2 then highlights the MTBs proposed by us. A statement is made of the key differences with the Government's MTBS.

9.1. The Government's MTBS

The Government's MTBs is presented in Table 9.1. It is unfortunately too aggregate in character and does not highlight the projected budgetary outcomes for the Federal and Provincial governments.

Table 9.1

Medium-Term Budgetary Strategy of the GOP

	Budget 2013-14	Revised Forecast 2013-14	Budget 2014-15	Forecast 2015-16	Forecast 2016-17
Real GDP Growth (%)	4.4	4.1	5.1	6.1	7.2
Inflation (%)	8.0	8.5	8.0	8.0	8.0
(as percentage of GDP unless otherwise indicated)					
Total Revenue	**14.0**	**15.1**	**14.5**	**14.6**	**15.1**
• Tax Revenue	10.9	10.6	11.5	12.1	12.9
• FBR Tax Revenue	9.5	9.0	9.7	10.4	11.1
Total Expenditure	**20.4**	**20.9**	**19.4**	**18.6**	**19.0**
• Current	15.2	16.2	15.2	14.1	14.2
• Development	5.1	4.7	4.2	4.4	4.8
Fiscal Balance	**-6.3**	**-5.8**	**-4.9**	**-4.0**	**-4.0**
• Revenue Balance	-1.2	-1.1	-0.7	0.4	0.9

• Total Public Debt	61.3	62.0	58.7	55.3	51.5
• GDP at market prices (Rs in Billion)	26,001	25,402	29,078	33,667	39,250

The key targets in this MTBS are as follows:

(i) Raise the tax revenue to GDP ratio from 10.6 percent in 2013-14 by 2.3 percentage points to 12.9 percent by 2016-17.

(ii) Reduce the current expenditure as percentage of the GDP by two percentage points from 16.2 percent in 2013-14 to 14.2 percent in 2016-17.

(iii) Keep development expenditure, more or less, at the same level in 2016-17 as in 2013-14.

(iv) Use the higher revenues and lower current expenditure ratios to bring the fiscal deficit down by almost two percentage points by 2016-17 to 4 percent of the GDP.

Before, a comment can be made on the above MTBS, it is necessary to highlight a serious error in the numbers for 2014-15. The level of development expenditure for the year is estimated at 4.1 percent of the GDP. But this is only the budgeted PSDP / ADP expenditures combined of the Federal and Provincial Governments. It does not include 'other development expenditure' of Rs 160 billion and 'development lending' of Rs 120 billion. This raises the development expenditure projection for 2014-15 from 4 percent to 5 percent of the GDP. Consequently, the expected fiscal deficit in 2014-15 is 5.9 percent of the GDP and not 4.9 percent of the GDP. Of course, this violates the target agreed with the IMF.

The fundamental flaw with the Government's MTBF is that it does not create any fiscal space for the larger portfolio of projects in the Federal PSDP as highlighted in Chapter 7.Inevitably, the annual size of the PSDP in 2015-16 and 2016-17 will have to be substantially larger if the energy sector development program and other 'mega' projects are to be executed.

9.2. The Alternative MTBS

The alternative MTBS is presented in Table 9.2. It has much greater disaggregation than the Government's MTBS. The objective is to clearly implement the key recommendations in the previous Chapters and to show them explicitly, as follows:

(i) As suggested in Chapter 5, the overall tax-to-GDP is proposed to be raised by two percentage points, with half the increase coming from direct taxes and the remaining half from direct taxes.

Table 9.2

Alternative Medium-Term Budget Strategy

2014-15 to 2016-17

(% of GDP)

	2013-14	2014-15	2015-16	2016-17
A. Total Tax Revenue by tax:	**10.6**	**11.2**	**11.9**	**12.6**
Direct Taxes	3.6	3.8	4.2	4.6
Indirect Taxes	7.0	7.4	7.7	8.0
By Government:	**50.1**	**46.5**	**47.0**	**42.8**
Federal	9.9	10.4	10.9	11.3
Provincial	0.7	0.8	1.0	1.1
B. Total Non-Tax Revenue	**4.5**	**3.1**	**3.3**	**3.5**
Federal	4.2	2.8	2.9	3.0
Provincial	0.3	0.3	0.4	0.5
C. Total Revenues	**15.1**	**14.3**	**15.2**	**15.9**
Federal	14.1	13.2	13.8	14.3
Provincial	1.0	1.1	1.4	1.6
D. Net Transfer of Federal Revenues to Provinces	**-5.5**	**-5.7**	**-6.0**	**-6.2**
E. Net Revenue Receipts of the Federal Government	**8.6**	**7.5**	**7.8**	**8.1**

F. Federal Budget	**8.6**	**7.5**	**7.8**	**8.1**
F.1. Net Revenue Receipts	*8.6*	*7.5*	*7.8*	*8.1*
F.2. Current Expenditure	*11.6*	*11.1*	*10.6*	*10.1*
Debt Servicing	4.7	4.6	4.8	5.0
Defence	2.5	2.7	2.6	2.5
Grants	1.5	1.3	1.0	0.7
Subsidies	0.7	0.6	0.5	0.4
Others	1.6	1.9	1.7	1.5
G. Development Expenditure	**3.1**	**2.8**	**3.3**	**4.1**
G.1. PSDP	*1.7*	*1.8*	*2.4*	*3.3*
Infrastructure	1.2	1.0	1.8	2.5
Social Services	0.2	0.2	0.2	0.2
Other	0.3	0.6	0.4	0.4
G.2. Other Development Expenditure and Net Lending	*1.4*	*1.0*	*0.9*	*0.8*
H. Federal Fiscal Deficit	**-6.1**	**-6.4**	**-6.1**	**-6.1**
Memo Items				
GDP Growth Rate (%)	4.1	4.0	4.5	5.0
Rate of Inflation	8.6	8.5	8.0	8.0

(ii) The Federal tax to GDP ratio is projected increase by 1.4 percent of the GDP and the provincial ratio by 0.6 percent of the GDP, in line also with the analysis in Chapter 5.

(iii) The provincial non-tax-to-GDP is increased by 0.2 percentage points, based on the proposals in Chapter 3 of increase in irrigation charges, highway tolls and fees for higher education.

(iv) The transfer of revenues from the Federal to the Provincial Governments is based on the assumption that there will be no material change in the vertical sharing formula in the forthcoming 8th NFC Award, in light of the Article 160(3A) in the Constitution.

(v) Current expenditure of the Federal Government is expected to fall by 1.5 percent of the GDP by 2016-17. This is consistent with the analysis carried out in Chapter 6. Debt servicing will rise moderately, but grants, subsidies and costs of civil administration are expected to come down significantly in line with the proposals made in the Chapter.

(vi) A major provision is made for a quantum jump in the size of the PSDP, especially the federal component, of over 1.5 percent of the GDP, in line with the execution of the Energy Sector Development Plan, described in Chapter 7.

(vii) The Federal fiscal deficit is expected to remain close to 6 percent throughout the period. This is likely to also be the consolidated fiscal deficit as the Provincial Governments will probably carry balanced budgets.

(viii) The availability of financial resources with the Provincial Governments is projected to rise from 6.5 percent of the GDP in 2013-14 to 7.8 percent of the GDP by 2016-17. This should enable Provinces to raise their social sector spending by at least 1 percent of the GDP and also spend more on agriculture, irrigation and energy.

What is the impact of a 6 percent deficit or slightly more on public debt? This is derived in Table 9.3. The public debt to GDP ratio falls in this MTBS from 62.3 percent of the GDP in 2013-14 to below 60 percent by 2016-17. This is the ceiling imposed by the *Fiscal Responsibility and Debt Limitation Act.*

Table 9.3

Projected Level of Public Debt

(Rs in Billion)

	2013-14	2014-15	2015-16	2016-17
GDP	**25402**	**28663**	**32349**	**36684**
Fiscal Deficit	1550	1834	1973	2237
Public Debt	15826	17660	19633	21870
Public Debt as % of GDP	62.3	61.6	60.7	59.6

In conclusion, the report has highlighted in-depth the elements of progressive fiscal policy, both on the revenue and expenditure side. Many may consider this as a 'wish list', especially on the taxation side which is unlikely to be implemented given the prevailing power structure in the country. But we have proceeded to develop the contours of progressive fiscal policy to demonstrate how far we are from the 'ideal' and in the hope that a time will come when most of the proposed reforms will be implemented.

ANNEXURE-1

73 Procedure with respect to Money Bill.

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(1) Notwithstanding anything contained in Article 70, a Money Bill shall originate in the National Assembly:

Provided that simultaneously when a Money Bill, including the Finance Bill containing the Annual Budget Statement, is presented in the National Assembly, a copy thereof shall be transmitted to the Sentate which may, within fourteen days, make recommendations thereon to the National Assembly.

(1A) The National Assembly shall consider the recommendations of the Senate and after the Bill has been passed by the Assembly with or without incorporating the recommendations of the Senate, it shall be presented to the President for assent.

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(2) For the purpose of this Chapter, a Bill or amendment shall be deemed to be a Money Bill if it contains provisions dealing with all or any of the following matters, namely:-

(a) the imposition, abolition, remission, alteration or regulation of any tax;

(b) the borrowing of money, or the giving of any guarantee, by the Federal government, or the amendment of the law relating to the financial obligations of that Government;

(c) the custody of the Federal Consolidated Fund, the payment of moneys into, or the issue of moneys from, that Fund;

(d) the imposition of a charge upon the Federal Consolidated Fund, or the abolition or alteration of any such charge;

(e) the receipt of moneys on account of the Public Account of the Federation, the custody or issue of such moneys;

(f) the audit of the accounts of the Federal Government or a Provincial Government; and

(g) any matter incidental to any of the matters specified in the preceding paragraphs.

(3) A Bill shall not be deemed to be a Money Bill by reason only that it provides:-

(a) for the imposition or alteration of any fine or other pecuniary penalty, or for the demand or payment of a licence fee or a fee or charge for any service rendered; or

(b) for the imposition, abolition, remission, alteration or regulation of any tax by any local authority or body for local purposes.

(4) If any question arises whether a Bill is a Money Bill or not, the decision of the Speaker of the National Assembly thereon shall be final.

(5) Every Money Bill presented to the President for assent shall bear a certificate under the hand of the Speaker of the National Assembly that it is a Money Bill, and such certificate shall be conclusive for all purposes and shall not be called in question.

80 Annual Budget Statement.

(1) The Federal Government shall, in respect of every financial year, cause to be laid before the National Assembly a statement of the estimated receipts and expenditure of the Federal Government for that year, in this Part referred to as the Annual Budget Statement.

(2) The Annual Budget Statement shall show separately-

(a) the sums required to meet expenditure described by the Constitution as expenditure charged upon the Federal Consolidated Fund; and

(b) the sums required to meet other expenditure proposed to be made from the Federal Consolidated Fund; and shall distinguish expenditure on revenue account from other expenditure.

82 Procedure relating to Annual Budget Statement.

(1) So much of the Annual Budget Statement as relates to expenditure charged upon the Federal Consolidated Fund may be discussed in, but shall not be submitted to the vote of, the National Assembly.

(2) So much of the Annual Budget Statement as relates to other expenditure shall be submitted to the National Assembly in the form of demands for grants, and the Assembly shall have power to assent to, or to refuse to assent to, any demand, or to assent to any demand subject to a reduction of the amount specified therein;

Provided that, for a period of ten years from the commencing day or the holding of the second general election to the National Assembly, whichever occurs later, a demand shall be deemed to have been assented to without any reduction of the amount specified therein, unless, by the votes of a majority of the total membership of the Assembly, it is refused or assented to subject to a reduction of the amount specified therein.

(3) No demand for a grant shall be made except on the recommendation of the Federal Government.

84 Supplementary and excess grants.

If in respect of any financial year it is found-

(a) that the amount authorized to be expended for a particular service for the current financial year is insufficient, or that a need has arisen for expenditure upon some new service not included in the Annual Budget Statement for that year; or

(b) that any money has been spent on any service during a financial year in excess of the amount granted for that service for that year; the Federal Government shall have power to authorize expenditure from the Federal Consolidated Fund, whether the expenditure is charged by the Constitution upon that Fund or not, and shall cause to be laid before the National Assembly a Supplementary Budget Statement or, as the case may be, an Excess Budget Statement, setting out the amount of that expenditure, and the provisions of Articles 80 to 83 shall apply to those statements as they apply to the Annual Budget Statement.

88 Finance Committees.

(1) The expenditure of the National Assembly and the Senate within authorised appropriations shall be controlled by the National Assembly or, as the case may be, the Senate acting on the advice of its Finance Committee.

(2) The Finance Committee shall consist of the Speaker or, as the case may be, the Chairman, the Minister of Finance and such other members as may be elected thereto by the National Assembly or, as the case may be, the Senate.

(3) The Finance Committee may make 183 rules for regulating its procedure. Ordinances.

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