Macropicture of the Budget 2000-01

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Mr. President, Distinguished Panelists, Ladies and Gentlemen.

I would like to thank you for inviting me to this seminar. I welcome such opportunities as it provides an occasion to listen to your feedback and views and for me to explain the rationale and reasons behind some of the decisions taken by us.

The previous speakers have done an excellent job in reviewing the key features of the budgetary proposals from micro perspective. I would therefore like to shift the focus to the strategic and macro picture.

Every budget has to be viewed in a certain strategic context. This second budget of the present government forms part of a medium term program of economic revival whose ultimate objective is to reduce the debt burden, get out of dependence on the International Monetary Fund and set the course of the economy on a path of self reliance.

This is the first budget after a very long time where the current revenues would be able to finance current expenditure. In other words we will borrow this

year only for development expenditure. If these expenditures are utilized for productive purposes and add to the infrastructure capacity or human resource development then the growth rates will be positive and the country will be able to repay these loans without much difficulty. For the past two years we have also been generating primary surplus i.e. budgetary deficit minus interest payments has been about 2% of GDP. This trend will continue in the coming fiscal year also and thus lead towards a reduction in debt-GDP and debt-revenue ratios which are quite high. This is the path which will ultimately lead to reduction in debt burden.

The same pattern is to be observed in the balance of payments. Non-interest current account has generated surplus during the year 2000-2001 and this is estimated at about $ 1.4 billion in the coming year. As you all know this surplus will be used to discharge our interest payments obligations and as the size of this surplus rises over time our debt servicing ratios will decline. So the larger is the non-interest current account, the more easily we will be able to manage our external payment situation.

Some commentators have criticized our action to tap the kerb market for building up foreign reserves and reduce the current account deficit. The simple truth is that in doing so we have avoided adding to the external debt burden of

this country. Had we borrowed short term commercial credits during these two fiscal years instead of making these purchases the stock of our external debt would have risen by at least $ 3.5 billion and our debt servicing bill by $ 300 million annually. We paid Rs. 2 – 2.50 per dollar as the premium for the purchases from the kerb market and thus did not incur any liability of payments in the future. After all, the money changers are providing an efficient and useful service by mobilizing the remittances of Pakistani workers in the Middle East and delivering them within 24 hours to their families in Pakistan. For this service and the network they maintain they charge a premium over the Inter-bank rate. Indirectly the country is benefiting from these inflows as it reduces our current account deficit and thus external debt burden.

The main tools for successfully implementing this strategy are increasing revenue collection and expanding exports. In the area of revenue collection we have to move away from penalizing the existing tax payers by putting burden of additional taxation or higher tax rates on their shoulders. We have to develop a much broader tax base. The on going documentation and survey should be seen as a major attempt to bring those outside the tax net into the tax base. Once we have developed a large tax base it should be possible to reduce the tax rates and thus improve tax compliance also. The second pillar of revenue collection is to cut down on the multiplicity of taxes at the levels of the Federal and Provincial

Governments. Since last budget a number of taxes have been abolished or eliminated and the Federal Govt. will end up having only 3 main taxes while the Provincial governments may have 5-6 or at best. Thirdly, the tax administration is being streamlined and contact between tax collector and tax payer will be minimized. Under the self-assessment scheme only 20% of tax returns filed will be audited. A comprehensive report on the restructuring of CBR has been approved and is likely to be implemented during the next few years. Hopefully, many of the grievances of the honest tax payers will be taken care of under the new structure and system of tax assessment, collection and adjudication.

To boost Pakistan's exports, we are pursuing a market based flexible exchange rate policy which will provide adequate price incentives to our exporters. It is true that the rupee has depreciated more steeply than the economic fundamentals warrant. The free float has accentuated the volatility but we hope that with larger foreign exchange reserves the element of speculation will subside. But the growth in non-traditional manufactured exports this year has been 20 per cent which shows the responsiveness to this exchange rate adjustment. Overall, the decline in unit prices of textiles had pulled us down but the developmental exports and non-traditional exports have performed extremely well. A number of specific sectoral studies are being carried out to identify and remove the non-price constraints which are impeding the faster growth of our

export sector. The Export strategy is aimed at penetrating new markets outside the U.S., Europe and Japan and also to widen the range of products which we are trying to export. There is no reason that the export performance of Pakistan should not match that of its neighboring countries. But Government policies and incentives are not going to do the trick unless the private sector exporters bring back their export proceeds in full to the country through official channels. We estimate that a 10% annual growth in exports for the next 3-4 years should place us in a comfortable position in relation to our external payment obligations.

Let me also inform you that it is also commendable that we have been able to contain the fiscal deficit at 5.3 percent despite a shortfall in tax revenues. As an economist I am not happy that this goal had to be achieved by cutting back Public Sector Development program but given the inflexible nature of our current expenditure there was hardly any other feasible option available. As you would recall Debt Servicing and Defence together pre-empt 80 percent of our current expenditures leaving very little scope for any significant reduction. The coming year's budget is projecting a 30 percent increase in Development expenditure while Defence and Running of the Civil Administration have been frozen at their current level. The expected increase in revenues of Rs. 51 billion is also not unrealistic. Assuming a 4 to 5 percent growth in real GDP and 5-6 percent inflation rate the autonomous growth in tax revenues will be

approximately Rs. 40 billion. Other revenue rationalization measures and the impact of documentation and survey should yield additional Rs. 11 billion.

This brings me to the legitimate criticism about the realism of tax revenue targets. We should distinguish between targets as a management tool to spur the tax collecting machinery into making their best efforts and performance indicator which measures the actual outcome. The targets assigned to the CBR are always ambitious; they are stretch goals to push the staff to the maximum. But the performance of CBR should be seen in light of the growth in tax collection which was 15 percent this year. The non-fulfillment of the targets can be explained by a host of factors which were not anticipated at the time these targets were formulated. For example, GDP growth rate this year has been much lower than what was assumed in June 2000. Dutiable imports which constitute 40 percent of total taxes were also much lower than expected. There were some concessions granted to the businesses in the documentation and tax survey. Thus it was unrealistic to expect that the original targets would be achieved. The debate and dialog will be highly productive and constructive if the Associations like yours and the practitioners such as Mr. Masood Naqvi undertake analysis of the deviations from the original assumptions upon which these targets were set. Only then we will be able to find out if the performance of tax collectors was upto the mark or not. Simply to criticize the CBR for not achieving the targets or to

question the realism of the target itself in absence of a variance analysis will not be very helpful.

Finally, let me conclude by saying that we have to stay on the course, move steadily and achieve our goal. Any deviation from the chosen path at this stage will once again generate greater uncertainty, inconsistency, unpredictability and loss of credibility. Despite the genuine difficulties faced by all of us we should stick it out for a better economic future.