BUDGETS AND THE REAL ECONOMY

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THE annual budgets of the federal and provincial governments should make a significant impact on the real economy, financial variables, social sectors, poverty and income distribution and finally make up the infrastructure deficit.

The real economy is affected in terms of output level, employment, growth rate, investment and savings. The financial variables affected are fiscal balances, current account, debt-to-GDP ratio and taxto-GDP ratios, etc. Social sectors such as education, health, water supply, social safety nets are directly impacted while poverty and income distribution are indirectly impacted. Infrastructure deficit can be made up by complementary private investment.

This impact analysis can only be carried out in conjunction with the monetary, exchange rate, trade and other sectoral policies. A partial analysis can, however, be attempted to highlight the possible positive and negative aspects of the budgets announced keeping this limitation in mind.

We could start by pointing out what is missing in these budget statements. The most glaring omission is that the actual achievements in respect of physical targets against the financial allocations made in the closing year's budget are neither presented nor discussed. A statement showing the original targets and actual achievements should be presented before parliament and the provincial assemblies, and the variance between the two should be adequately explained and disclosed.

The sanctity and credibility of the budgets can be enhanced through this mechanism incorporating the lessons learnt from failures and lapses. In the absence of this, each year`s budget will repeat the same mistakes and there would be no improvement in or reflection of the actual realities. A positive aspect of this year`s budget is the transfer of power to issue SROs from the Federal Board of Revenue to parliament. This will, hopefully, increase transparency levels in the grant of these exemptions and concessions and also promote open debate and discussion about their justification.

It is also not possible to infer from the budget documents how much additional revenues have accrued due to the reversal of the exemptions and concessions removed under the SROs in the budget. The estimates made before the budget ranged between 2pc to 3pc of GDP. The actual tax collection during the year does not reflect even a fraction of these estimates. The latest Economic Survey, on the contrary, shows an upward increase in tax expenditures. It would also be helpful if corporate taxes realised from businesses are shown separately from individual income tax. Another useful piece of information would be to have a separate entry on the amount of taxes collected from first-time filers.

Tracing the consequences of these budgets for the real economy, we need to first identify the transmission channels that have direct effects. First is the nature, quality, duration and magnitude of public investment projects completed during the year. The rate of completion has slowed down; it takes twice the time relative to the original plan resulting in cost overruns and lower benefit stream. Private investment that is dependent upon availability of these completed projects remains subdued with adverse consequences for output and employment.

It is not clear when this menace of `throwforward` in the development budgets will be meaningfully dealt with. Political courage is required for this.

Second, as 80pc of economic output is generated by the private sector, the incentives provided through the budgets can create a conducive business environment. The exporting community`s perpetuating grievance against the existing refund and rebate regime has not been addressed. Their liquidity and weak cash flows resulting from these stuck refunds, along with energy shortages, are impediments to meeting export orders.

Fake and fraudulent transactions take place through the connivance of unscrupulous businessmen and corrupt tax officials while legitimate exporters have to spend a lot of time following up on their claims. The whole atmosphere of tax collection remains vitiated and adversarial and no headway has been made in this budget to find an innovative solution to this problem.

Third, those already in the tax net complain they are constantly being harassed by lower FBR functionaries in order to meet their targets. The whole regime of presumptive and withholding taxes without any active involvement of these officials has diverted their attention towards those who file their tax statements assiduously. The current year`s budget has further expanded the scope of presumptive taxes rather than streamlining or gradually substituting these by direct income tax filing and assessment. This opens the avenues for avoiding full disclosure of total tax liability.

Fourth, there is a lack of coordination between the federal and provincial revenue authorities in the collection of sales tax on services. An integrated common market for goods and services requires uniform treatment across jurisdictions. The FBR and the PRAs should enter into consultations and arrive upon arrangements whereby taxpayers do not have to be subjected to multiple tax incidence and rates and a single filing should suffice for all purposes.

Firms that have a national presence have to be saved from the additional costs of filing tax returns across different jurisdictions.

Fifth, the provinces, after the NFC award, are no longer interested in mobilising their own taxes thus keeping their electorates appeased. In India, the state governments contribute almost one-third to aggregate national tax revenues while in Pakistan the contribution of the provinces is less than one tenth. There is no way that taxes on agriculture income and urban property can be kept at such negligible levels and the tax-to-GDP ratio be expected to rise to 15pc. The current year`s budgets follow past pattern and show no signs of any serious commitment to tax these undertaxed incomes.

To conclude, public investment projects should be expedited for completion and incentives to the private sector for generating higher output, incomes, exports and employment could be better structured in the federal and provincial budgets to maximise the impact on the real economy. The writer is dean and director at the Institute of Business Administration, Karachi.