

BUDGET 1987-88: IS THE GOVT PREPARED TO FACE THE REAL ISSUE

Reference to be provided by Prof. Khurshid

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New budget is expected to be announced on June 4th. The common of man is scared of a new spate of taxes and fresh price-hikes, as somehow these apprehensions represent his image of the budget! On the other hand, the bureaucrat's main worry is how to square the accounts in the face of a budgetary gap running around 10-12 billion rupees. But budget is neither merely a catalogue of new taxes nor an exercise in balancing books of account. It is something more fundamental and paramount: it is the most important socio-economic document highlighting the policies, programmes and strategies of the Government. It is also a document on the basis of which the past record as well as the future commitments of a Government is evaluated. Budget session constitutes an hour of reckoning: a mechanism through which parliamentary the control over the finances of the Government is exercised. It is, therefore, worthwhile to briefly identify the challenges that presently beset the economy today. They go to make-up the touch-stone on which the success or failure of the budget and of the socio-economic policies of the Government will be judged.

The forthcoming budget would be the third budget of the Junejo Government, and the second one by the present finance minister. So the excuse of being newcomers is no longer available. Similarly, the Report of the National Taxation Reform Commission was submitted to the Government in December, 1986 and was placed before the Parliament. A lot of discussion has taken place on issues raised or ignored by the Commission. Reports of other Commissions formed in 1985 have also reached the Government. If the new budget fails to face the fundamental issue of radical overhaul of the tax system, it would be an index of the incompetence of the Government in facing real issues.

We would like to group our observations in two sections. First, we would like to focus attention on the institutional arrangements for the preparation and discussion of the budget. In our view much is lacking in this respect with the result that budget is not given the importance it deserves. In the second part of this paper we shall highlight some of the economic challenges the Government must face and come out with clear policy answers in the budget and the Seventh Development Plan.

PARLIAMENT AND THE BUDGET

The way budget is made behind the smoke-screen of make-believe secrecy and uncertainty and the manner in which it is rushed through the Assembly are a disgrace for a sovereign parliament of an independent country. This makes a mockery of the government accountability before the people and their representatives.

Budget session has become something mechanical and a routine affair, with ritualistic platter in the general discussion and total lack of real scrutiny of the Government finances and demands for grants at the decisive stage of approval of demands and appropriations. In the U.K. the parliament is ceased of the budget and the budgetary issues almost throughout the year. Estimates for the

public services are tabled in February. In the same month Defence Vote of Account is tabled. Spring supplementary estimates are tabled in February or March. Summer supplementary estimates are submitted in June or July. Winter supplementary estimates are introduced in November. The budget estimates are presented during the first fortnight of April and given legislative effect by the end of July. The whole parliament turns into Estimates and Ways and Means Committees to examine the budget in depth.

Most parliaments of the world normally devote between 2 to 4 months to the examination, discussion and approval of the budget. In Italy the Parliament spends around six months on discussion on budget. Parliaments in Denmark, Canada, Netherland and Sweden spend around four months discussing the budget. Belgium, Brazil, Costa Rica, France, Israel, Japan, Republic of Vietnam devotes three months to budgetary discussions. Even in India around two months are spent on budget. It is only Pakistan where budget is disposed of in odd three weeks. (See Parliaments of the World, A Reference Compendium produced by the Inter-Parliamentary Union, London, Macmillan, 1976, pp. 773-791)

In view of the specialized nature of budgetary appropriations and the vital role elected representatives play in sanctioning expenditure and imposing taxes most of the parliaments of the world do not take into consideration the budget directly in the House. Instead, after the budget is formally introduced it is either referred to one or more Permanent Standing Committees or to a special committee which has powers to deal with all financial matters. In 22 countries budget is referred to such a special committee which is regarded as the most powerful committee of the parliament. In certain countries the budget is examined by a number of Standing Committees specialized in their respective areas in before discussion/the Parliament begins. That is how real contribution is made by the parliament. This also enables the parliament to effective control the financial activities of the Government and keeps the executive accountable before the elected representatives.

Secondly, in all those countries which have bi-cameral parliaments both the houses play significant role in financial matters. ^In Argentina, Brazil, Checkoslovakia, Switzerland, USSR and the United States of America the two houses have almost equal powers in financial matters. Even where the Second House does not enjoy equal powers in financial matters it plays an important role through discussion on the budget, and voicing its recommendations. Normally it can also delay approval for a limited period, one more method to bring to light aspects of the budget which need alteration. In some countries (Italy and Switzerland) the budget is introduced alternatively into each house every year. In others (Federal Republic of Germany, India and the USSR) it is introduced simultaneously into both houses. In others (Brazil, Norway) it is introduced in a joint session of the whole parliament. Even in countries where it is presented in one house, it is simultaneously placed at the floor of the other house for discussion. While there can be differences in the powers of the two houses in respect of financial matters, it is totally unjustified that the Senate in Pakistan has been totally denied any direct role whatsoever in budget- making. This not only deprives the country to

avail of the expertise available in the Senate but it is against the very principle of federation on which the Constitution of Pakistan is based.

Thirdly, real input in budget making from research, learned organizations, academic institutions as well as specialized groups outside the Parliament is insignificant, despite the ritual of pre- budget consultations. Government lacks research institutions and policy-review organizations which would provide alternate perspectives on the economy. The involvement of the private sector, particularly not research and academic institutions, is/more than decorative and that is why our budgets are primarily the brain-child of the bureaucracy, with some window-dressing by politicians, whose grip over the economic and financial matters leaves much to be desired.

Fourthly, the Planning Commission has become a rather ineffective organ of the State. Originally its function included the task of bring into sharp focus long period policy perspectives, keeping in view the needs of the provinces which were equally represented in the Commission. Pakistan Institute of Development Economics used to work as an autonomous research arm of the Commission. No effort has been made to properly re-organise the Commission in the light of the present realities of the country. The effort made in 1979 to transform the Planning Commission into a National Planning Council provides a still birth. There is no effective commission at the top, and there are no vertical linkages through effective planning boards at the provincial and district levels. Absence of structural arrangements has resulted in over-centralization of the economic widespread dissatisfaction at the provincial and these it is suggested that:

- a) more time should be given to the Parliament to discuss the budget;
- b) An Estimates and Ways and Means Committee, preferably as a Joint Committee of the Parliament, be formed to examine the budget in depth;
- c) Constitutional amendment to increase the role of the of the Senate in financial matters;
- d) Establishment of Prime Minister's Council of Economic Advisers, as an independent policy review organization, so as to enable the Government to have some alternate policy perspectives;
- e) Reconstitution of the Planning Commission on a broader basis and establishment of effective functional Planning Boards at least at the provincial levels; and
- f) Less secretive approach to economic policy making in the country, with greater participation from members of the Parliament, research and academic organizations, socioeconomic groups, etc. and more profound national debates on issues of vital significance.

This shall improve the quality of policy-making and budget-formation in the country on a more permanent basis.

CURRENT ECONOMIC CHALLENGES

First, it must be frankly realized that there is a general dissatisfaction in the country over the Government's obsession with the growth rate and a few macro-indicators, to the neglect of the real socio-economic realities of the country. This GNP-fetishism has distorted our economic perceptions and planning priorities. The fact is that the country is faced with a serious problem of unemployment and under-employment. Despite thirty years of planning there is little improvement in the quality of life of the vast majority of the people. There are gross and even increasing inequalities of income and wealth producing serious tensions in the society. Conspicuous consumption is rampant in the Government as well as private sector, with the result that the sense of deprivation of the under-privileged sections of the society is aggravating, assuming explosive promotion. The nation has become addicted to living on debts. Not only is the international indebtedness disproportionately high, domestic borrowings have reached totally unacceptable proportions, becoming a heavy drain on future development. Black economy is thriving, according to certain estimates around one third of the economy is under-ground. The Government is openly patronizing this black economy through a number of financial outlets it has provided to create havens for black money. Tax evasion is rampant to an extent that almost double the amount of what is being paid as income tax is evaded. Domestic savings are at a palpably low level, endangering the whole developmental efforts in the future. Exchange rate policy is resulting in a process of continuous devaluation of the Pak Rupee. As a country we are eating our capital and are not providing adequately for the needs of the coming generations.

Over-centralization of Government finances and administrative arrangements have taken place during the last two decades, producing bitter reactions in provinces and regions. While this is the actual state of affairs, Government functionaries are not tired of claiming that all is well and that the GNP is rising' around 7 percent per year. A more realistic approach is needed to the entire economic problem otherwise we would be guilty of burning our candle at both ends and not realising what damage we have done to our people, particularly the posterity.

REFORM OF THE TAX SYSTEM

Secondly, there is a widespread realization that the tax system of the country needs total overhaul and radical restructuring, and not merely a few piece-meal changes here and there. While the National Taxation Reform Commission has accepted this position its report is rather disappointing. It has by and large skipped over the ideological and the socio-economic context of the country, has concentrated on a few issues (for example, tax evasion, smuggling and corruption) to the neglect of all other major failings and distortions of the system, has tried to suggest primarily procedural or punitive solutions to more fundamental changes, structural problems that called for more

fundamental changes has neglected the issue of restructuring of the tax system at macro-level in the light of the ideological and socio-economic aspirations of the people. In a country of with over 95 million people of who around 30 percent live in urban areas, the total number of tax assesses is only 1.2 million, of who almost one third are moribund. Even in the urban population real tax assessees are not more than 3 percent. No effort has been made to educate the common man to participate in the process. Even the tax return forms are not available in the national language or the local languages. English is the medium in tax matters although 98 percent of the people do not know it.

When we examine the total tax paid by these assessees a very dismal picture emerges. 96% of the total tax revenue is paid by only 8% of the assessees i.e. those whose income is more than Rs. 50,000 a year. The share of direct taxes in total tax revenue which is normally around 20% in countries at similar level of development is presently around 15% only. Actually, it has fallen from 18% of total tax revenue to 15%. The tax base of customs duties, the main revenue earner, is also very narrow. Only 10 items contribute around 42% of the revenue while 50% of the imported goods are exempt from custom duties. The situation in respect of excise duty is not different. Only 7 items contribute 80% of the excise duty.

While a person with income of Rs. 24,000 a year in the urban sector has to pay some income tax, the very affluent in the agricultural sector whose annual income may run into millions, are totally exempt from income tax. Tax evasion and corruption are rampant in every field. There are also gross structural inequities in the tax system. While the incidence of indirect taxes is more on the agricultural sector with the result that the poorest in the rural sector are shouldering burdens unjustifiable on any count, moral, political or economic. The incidence of direct taxes on the agricultural sector is unbelievably low i.e. only 0.5 percent. This calls for a total restructuring of the tax system, with a view to ensure equitable incidence of taxes on different regions of the country or sections of the society.

It is proposed that income tax and corporate tax should be treated separately. The rate of corporation taxes may be reduced to make them reasonable and acceptable to the payers, which may result in making tax payment economically profitable and as such curb the under-ground economy. We are sure that reduction of the tax rate and widening of the tax base would make the system more buoyant and revenue elastic. It may be suggested that 25% on the net profit of public limited companies and 30% on the net profit of private limited companies could be a reasonable rate. A Super Profits Tax can be levied on companies earning profits beyond a particular ceiling.

Income tax on salaried classes as well as on the small and medium business enterprises has proved to be unjust and exploitative. This system has become obsolete and a source of corruption. It is therefore suggested that a major decision should be made in this respect.

An alternate system could be the one suggested by the Senate Sub- committee on NTRC report which I had the honor to chair. The main feature of the proposal is a simplified flat rate of taxes on income slabs starting from those earning Rs. 48,000 a year and going upto those earning more than Rs. 400,000 a year. The Sub-committee has suggested ten slabs; lowest taxpaying group would have income between Rs. 48,000 and Rs. 70,000 and would be obliged to pay Rs. 750/- a year. ^The highest tax paying group would have income over Rs. 400,000/' per year and would have to pay Rs. 90,000/- per year. In this system tax paid would go to make 1.07 percent of the income for the lowest group to 22.5 percent of the income by top-most group. A major characteristic of the system is that it becomes self-enforceable. Once a person has paid a fixed amount of tax he has no worry about the tax collector. The only issue-that can be-debated relates to the relevant income group a person. It would be on the basis of 100% self-assessment. There would, however, be an autonomous agency known as Vigilance and Review Authority which would keep a constant eye on the total economic landscape of the country and see whether the information given on the basis of self- assessment is in keeping with the reality or not. Wherever they find significant divergence they can refer the case for judicial enquiry. It would also be essential that there should also be a separate Oration Authority which would register all businesses in the country and only on the basis of the registration with this authority can one engage in any business in the country. This would help the entire economy to be on the record and the tax system we are suggesting would not be an incentive to go for the under-economy, the overall impact on the economy would be very salutary. There should be no secrecy about tax payments. All tax payments should be publicly announced so that the conscience of the society plays a role in making people fulfill their tax obligation.

The central idea is that the tax collector should have no contact at all with the tax payer, both in the informal sector as well as the corporate sector. 'Business Registration' and 'Vigilance and Review' should be functions of autonomous bodies that can only pass on their information to the Central Board of Revenue. They would not have any role to play at all in assessing the income or negotiating tax with would simplify the system and enable everyone to fear of being haunted by the tax collector. This would help in eliminating corruption and tax evasion.

Reorganization of the law as well as the tax collecting arrangements in respect of excise duty, customs duties, and sales tax are also needed. We are in favour of greater reliance on excise duty and sales tax. Rationalisation of import duties is long overdue. There are strong inter-linkages between the three which have not explored in Pakistan. Progressivity can also be built into In the case of excise duty maximum resort should be made to the principle of capacity taxation. Single rate across the board sales tax is not advisable as suggested by the NTRC report. Instead sales tax should also be at different rates (limited slabs) to make it progressive and also to use it as an instrument to encourage desirable pattern of consumption in the country, in keeping with the demands of an Islamic Welfare State.

REDUCE PUBLIC EXPENDITURE

Thirdly, Government expenditure, particularly non-developmental expenditure, has been increasing at a rate which cannot be justified on any count. The combined current expenditure of the Federal and Provincial Governments, over the decade ending 1986-87, is estimated to have increased over five fold, from Rs. 20.1 billion in 1976-77 to Rs. 107.6 billion (Budgeted). During the same period developmental expenditure is estimated to have increased only three fold with the result that the share of development expenditure in total expenditure of the Federal and Provincial Governments which stood at 42.6 percent in 1976-77 has fallen in 1986-87 to only 30 percent.

Another very grave feature of the country's public finance relates to Government's unprecedentedly high borrowings from non-bank recorded domestic sources. They, have" / an almost ten-fold increase during the last eight years. The present situation is that a significant part of the current expenditure is being met from borrowings. Nothing could be more dangerous and destabilizing for the future of an economy. It is therefore proposed that public expenditure must be drastically reduced. It has been reported by at least two committees of the National Assembly that huge resources have been misappropriated in different Government departments. The Minister for Planning is on record to have claimed that around Rs. 40 billion a year are being misappropriated by those responsible for running the affairs of the country. The scope for reducing public non-developmental expenditure is vast and the Finance Minister must ensure strict austerity in the coming years. If he expects people to co-operate in providing new resources to the state, reduction in non-development expenditure, particularly in administration, subsidies and interest payments, are a sine qua non for the same. Secondly, we propose that there must be a legal limit to Government borrowings both from the Central bank as well as from the non-bank sources. The impact of the later on domestic savings and investment is very disturbing, switch over to profit-sharing system has become more difficult of the schemes of the Government which are basically interest-based and are being used primarily to meet the budgetary gap.

WHITHER ISLAMIZATION?

4. Islamization of the economy has not only been stagnating but there seems to be a movement in the reverse gear. Interest has been rehabilitated in a number of ways including the perpetuation of the issue of Bearer Bonds, Bearer Certificates, Foreign Exchange Bonds, etc. Treasury bills are being floated on the basis of interest. The banking system has failed to move in the direction of real profit and: loss sharing and its lending policies have become even more exploitative. In Iran within two years over forty percent of the Bank financing is on the basis of Mudaraba or Musharaka. In Pakistan over eighty five percent of bank lending is on the basis of the dubious mark-up. This has made the whole exercise of Islamization of banking meaningless. Government agencies have become so bold in taking liberties with Islam that on the one hand Zakat collection is compulsory on financial assets, and on the other bearer bonds and even WAPDA bonds are being issued with open declaration that they are Zakat-Free? Why this contradiction?

It seems as if the whole experiment towards Islamization is being reversed. The Government must make up its mind and speak it out openly. In this respect it is proposed that (a) a high powered Parliamentary Committee should be constituted which should also have people having expertise in economics and Islamic fiqh to review the whole process of the alleged Islamization of the economy and come out with immediate and long period measures to really transform the economy in accordance with the Islamic values and principles. There should also be (b) a Shariat Board attached to the Banking Council to oversee the process of bringing banking and financing techniques into conformity with the clear injunctions of the Quran and Sunnah. Finally, there should be thorough debate in the Parliament as well as in the nation on this issue.

DEFENCE FUND

5. There is a need to have a separate Defence Fund to meet the defence needs of the country. Presently around half of the budget goes for defence and in view of the aggressive policies of the present regime in India it has become extremely essential to significantly improve the defence capabilities of the country. People would be prepared to sacrifice to an unlimited extent to strengthen the defenses of the country provided they are assured that every rupee that they give is honestly used to improve the real defence capabilities of the country. It is therefore proposed that there should be a National Defence Council in which along with top military leadership there should be representatives of the Parliament (both from the Government and Opposition). Every effort should be made develop a National Defence policy. There should also be greater accountability in respect of the defence expenditure. All wastes and unnecessary administrative expenditures should be drastically curtailed. Instead of pomp and show emphasis must be on real fighting capability. The people should also be confident that there are no commissions and kick backs in defence purchases. Even the defence structure deserves to be reviewed so that on the one hand we have a really efficient army equipped with latest technology and on the other every male member of the society is so trained that he could be mobilized for defence of the country whenever there is a need. Defence production within the country also needs to be planned. With such reorganization and increased accountability there is no reason why the nation would not be prepared to make more resources available for the defence of the country, 'even in the form of direct tax to be paid by every individual in proportion to his financial ability, or a defence surcharge on imports, domestic production, or on selected items of consumption, etc.

EDUCATION

6. Education is the second sector which should have its own fund, separate from the consolidated fund. Mobilization of greater resources for education is the only way to set the country along the path to sustained development. Yet, despite Iqra Surcharge no real feasible improvement in the state of education has taken place. This has adversely affected the confidence of the people. It is, therefore, proposed that there should be a National Educational Council which should be responsible for the entire educational budget and educational policy making in the country. This too

should be on national basis and not on partisan basis. Federation and Provinces should be properly represented on it. It should operate above the level of party politics. All resources made available for education must go to a separate educational fund controlled by the National educational Council. There should be a long period plan to transform the educational landscape of the country within the next two decades, both from an ideological perspective, and with a view to improve the quality of education and relating it to the manpower requirements and the region.

UNEMPLOYMENT

7. In the eyes of the present writer perhaps the most challenging problem the country will have to face in the next five years is that of unemployment. The country has lacked an employment strategy and an effective labour policy. The assumption that the level of unemployment is around 3 to 4 percent is totally unfounded. The real rate of unemployment is anywhere around 15%. And if the rate of under-employment (10-15 percent) is taken into account the total incidence of unemployment would be between 20 to 25 percent of the total labour force in the country. To ignore a problem of this dimension is catastrophic. The next budget and the Seventh Five Year Plan must give top priority to the employment problem.

OVER CENTRALIZATION OF REVENUES

8. Another extremely important issue relates to the over-centralization of national public finances. The total tax and non-tax revenue of all provincial governments account for only 19.4 percent of their general revenue receipts (1986-87) while 80.5 percent represent Federal Tax Assignments and Grants. Baluchistan and NWFP depend on the Federation to the extent of 75.1 percent and 64.2 percent respectively of their total receipts. The National Finance Commission has failed to address itself to this basic question. It is also disturbing that the proportion of provincial ADPs in the total development programme has shown a downward trend over the last 15 years. During 1972-73 to 1979-80 the share of provinces in the overall ADP decline from 41.7 percent [to 16.5%. Presently the aggregate share of the provincial ADPs is 25.5 percent of the total yet it is far below what the provinces use to contribute relatively to the development programme in 1972-73.

The whole situation deserves to be examined in depth. One of the reasons that Senate should have a greater say in financial matters relates to the fact that this deteriorating situation is not being handled properly by the Government. There should be a re-allocation of different taxes between the centre and the provinces so that provinces.
