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Beyond tweaks and turns

AS of writing this, the so-called mini budget has not been announced, so it is not possible to write about what it contains. For now, suffice it to say that mini or not, the economic challenges confronting this government will require more than a few tweaks to the fiscal framework to rectify.

Let's start with a few of the major problems facing the government that require a sure-footed policy response.

In no particular order of importance, take three examples: the circular debt, the narrow tax-to-GDP base, and the scourge of the trade deficit that in the previous decade and a half has twice depleted Pakistan's foreign exchange reserves to the point where the country has had to turn to the IMF for emergency balance-of-payments support.

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Others may well add more items to this list, but for now this is enough to get the conversation going on where the government is headed. It is no longer 'too soon' to be expecting such a plan, considering it is not 'too soon' for an incentive package to revive growth and investment.

Start with the circular debt. It consists of two elements, the flow and the stock. The flow is the amount that is added daily to the balance of outstanding payments owed by the government to the power producers and fuel suppliers. The stock is the total amount that stands outstanding. The figures on this vary depending on who you ask, because the government prefers to calculate the stock differently from others.

Be that as it may, consider that the total amount outstanding is now on track to touch Rs1.5 trillion by end of the fiscal year (if present rates of accumulation continue). The big question is: what is the government's plan to deal with this problem? At the moment, there is no visible plan whatsoever, except for a few stray announcements of a Sukuk bond to raise some of the funds required to keep the turbines running.

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A credible plan would seek to stem the flow, to arrest the increase in the circular debt first then turn to handle the stock. It would have governance reforms, oversight of the power sector, an emphasis on reforms and innovations in billing and recovery as well as financial management in the public companies that comprise the power sector. It would also have a timeline and benchmarks to measure progress.

We have nothing of the sort at the moment. If the government fails to come up with a credible plan to stem the flows and reduce the stock of the circular debt, there will be no option but to resort to plan B: power tariff increases. In the technical parlance of the power sector, this is 'full cost recovery', which basically means that the cost of the losses should be recovered from those who are paying their bills honestly.

The case is the same when it comes to broadening of the tax base, possibly one of the oldest priorities in our economic management. It has been a decade since the country lost its focus on this important priority. The last serious attempt to broaden the tax base was in 2010 when the so-called RGST bill was introduced, which was basically a value-added tax. It was the only structural performance criterion required under the IMF programme signed in 2008.

Since that bill was defeated, the fiscal space has been decimated by the heightened provincial transfers under the NFC award, while the tax base has not grown in any meaningful way, paving a path for a near-catastrophic fiscal situation. And since then, the base-broadening priority has devolved into gimmickry, such as the growing taxes on non filers of tax returns. That is a good step to ensure compliance, but it does nothing to bring the growing services sector, which accounts for almost 50 per cent of GDP today, into the tax net.

For the five years of the PML-N, revenues increased on the back of higher total economic growth, as well as a crushing burden on those within the tax net under the garb of withholding taxes. Today, the tax base has been squeezed to almost a breaking point and instead of talking about broadening the base to generate more revenues, the focus of those lurking in the shadows of power is on rolling back the provincial transfers.

This is malignant politics. Trying to increase the fiscal space of the federal government through administrative jugglery that seeks to roll back provincial transfers will have a terrible outcome, possibly even worse than burdening compliant taxpayers.

And last but not least, the trade deficit is eating away the country's foreign exchange reserves, and whatever growth the economic managers can produce through higher government spending exacts its terrible cost from the balance of payments. So long as the trade deficit remains in place Pakistan will never be able to afford economic growth.

And the trade deficit is not the result of anything as simple as the cost (or ease) of doing business in Pakistan. It is the result of eroding productivity over the long term. Pakistan was a cotton exporter back in the 1980s, when the shift was made to the private sector as the source of all future investment to drive growth. It remains a cotton exporter to this day.

Let me say this in all seriousness: the last place to seek a revival in exports is among the exporters. If the government is serious about tackling the trade deficit, it should be speaking with people in the IT sector, and find out what it will take to broaden the base of our exports beyond cotton.

The mini budget is a passing affair. It will contain a few incentives here and there. The real story the government has to deliver is the lasting one, and without credible plans on these three crucial areas, it makes no difference what tweaks they're bringing to the structure of taxes and customs duties.

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