Chapter-17

BUDGETARY POLICY OF PAKISTAN

1. ROLE OF FISCAL POLICY IN ECONOMIC DEVELOPMENT OF PAKISTAN

Fiscal Policy of Pakistan:

Fiscal policy is one of the important methods of fine tuning the economy of the country. **It is defined as changes in government expenditure and taxation so as to influence the pattern and level of economic activity in the country.** Fiscal policy of Pakistan is playing an important role in continuously increasing rapid economic growth. For attaining sound and rapid economic development in the country, the fiscal policy of Pakistan is based on the following objectives.

Objectives of Fiscal Policy:

The objectives of fiscal policy are not specified because they change with the level of economic development of a country. For instance, the objectives and the role of fiscal policy in developed countries of the world are promoting stabilization of economic activity at very high levels of output and employment free from inflation. In developing countries including Pakistan, the objectives of fiscal policy generally are:

1. To encourage economic growth in an atmosphere of stability.
2. To achieve greater equality in the distribution of income.
3. To reduce regional disparity in per capita income in various parts of the country.
4. To restrict import to essential items.
5. To provide incentives for increased savings and investment in the country.
6. To increase agricultural and industrial production for consumption at home and for export abroad.
7. To achieve desirable level of prices in the country.
8. To regulate resource allocation and increase export to earn foreign exchange.
9. To check rapid increase in consumption.
10. To attain maximum well-being of the people.
11. To reduce poverty by efficient allocation of resources.

The above objectives cannot be achieved without proper planning. The Government of Pakistan is tapping various sources for raising its income to meet the growing development expenditure. It has made necessary modification in the tax structure to make it more responsive to increase in economic activity.

Techniques of Fiscal Policy:

The main techniques of fiscal policy of Pakistan are as under:

(i) Taxation Policy (ii) Public Expenditure Policy (iii) Public Debt Policy and (iv) Deficit Financing Policy. These four policies are now discussed in brief.

(i) **Taxation Policy:** One of the important sources of the revenue of the Government of Pakistan is the tax revenue. Both direct and indirect taxes are levied to raise the revenue. The share of direct taxes in total taxes was **38.5%** and of indirect taxes **61.5%** in 2007-08. During **2008-09** the direct taxes were **38.2%** and indirect **61.8%**. During **2009-10**, direct tax share increased to **39.6** and indirect decreased to **60.4** percent. During **2010-11** direct taxes decreased to **38.7%** and indirect increased to **61.3%**. In **2011-12** the share of direct taxes increased to **39.2%** and indirect taxes decreased to **60.8%**. The tax collection has increased but still the tax to GDP ratio is **10%** which is very low compared in advanced countries which is around **30%** of GDP. However, the fiscal deficit which averaged **7%** of GDP in the **1990's** declined to **5.2%** in **2008-09** but increased to a level of **6.2%** in **2009-10**, **6.8%** in **2011-12** and **8.8%** in **2012-13**. Fiscal deficit reduced significantly to **5.3%** in FY **2015**, **4.6% in** FY **2016**, **5.8% in FY 2017 and 6.5% in FY2018.** During first nine months of FY2019 fiscal deficit as percent of GDP reached 5.0 percent as compared 4.3 percent in comparable period of last year.

(ii) **Public Expenditure Policy:** Public expenditure plays an important role in the economic development of a country. The total expenditure of the Government of Pakistan is estimated at **Rs. 8,135.9** billion in for the year **2019-20**. Out of it, a sum of **Rs. 1,650** billion had been allocated for public sector Development Programmes.

(iii) **Policy of Deficit Financing:** Considering the low level of income, low rate of savings and capital formation, the Government has been resorting to deficit financing in Pakistan. Bank borrowing is on the increase. To finance the higher fiscal deficit, the government mobilized financing of Rs 524.5 billion from external resources, which was at about the same level as last year. Another Rs 1.4 trillion were mobilized as borrowing from the domestic banking system and from public (mainly through national savings schemes) and some other non-bank resources. Banking system contributed domestic financing during the first nine months of FY2019 was 46 percent higher than last year. External resources contributed a little more than one quarter (27 percent) of total financing, banking system 41 percent and non-bank sources the remaining 32 percent.

(iv) **Public Debt Policy:** As the tax paying capacity of the people is low in Pakistan, therefore, the Government of Pakistan is taking recourse to public debt for financing its development expenditure. The domestic debt was **Rs. 18,171** billion in March 2019 and foreign debt was **Rs. 10,437** billion by end of March 2019.

Shortcomings of Fiscal Policy of Pakistan:

There is no doubt that the Government is making all efforts to mobilize resources for attaining rapid economic development in the country, but it has not achieved satisfactory progress in the following areas.

(i) **Defective tax structure:** Pakistan yet has a narrow tax base. The share of direct taxes is low. The tax structure on the whole is burdensome to the poor.

(ii) **Inflation:** Fiscal policy has failed to contain the rapid rise in the price level.

(iii) **Negative return of the public sector:** The Government of Pakistan is allocating huge amounts every year in the budgets for investment in public sector units. The capital invested in these units is giving a negative return. The Government of Pakistan is privatizing all these white elephant in a phased programme.

(iv) **Rising poverty and inequality in income:** The fiscal policy has failed to reduce the level of poverty and inequality in the distribution of income and wealth. The gap between the rich and poor is widening as the years pass.

(v) **Instability:** The fiscal policy has not shown positive results in various fronts such as, inflationary rise in the price level, dis-equilibrium in balance of payments, etc.

The Government of Pakistan is quite aware of the weaknesses of its fiscal policy. It has introduced effective tax reforms.

2. BUDGET FORMULATION

What is a Federal Budget?

Every government plans various economic activities and for undertaking these activities, it has first to raise revenues and then incur expenditures.

Federal budget is the annual statement of the expenditures and revenues of the federal government with the laws and regulations that approve and support those expenditures and taxes. The main objectives of the federal governments of the developing and developed countries of the world are:

(i) to finance the activities of the federal government and

(ii) to encourage economic growth in an atmosphere of stability.

The first purpose of the federal budget is to finance the business of the government by raising revenues through direct and indirect taxes. After the Great Depression of 1930's, the federal budget is used through the fiscal policy to achieve macro economic objectives such as sustained long term economic growth, higher level of employment, price stability etc.

Budget is very often divided into revenue and capital budget. The **revenue** budget covers items of recurring nature. The government raises revenue from direct and indirect taxes such as income tax, excise duty, custom duty etc. The **Development budget** includes those items which are meant for acquiring and disposal of capital assets. The development expenditure includes expenditures on construction of roads, railways, parts, industrial projects, irrigation projects etc.

Generally the budget paper shows (i) the financial accounts of the previous year, (ii) the budgeted figures and revised estimates for the current year (iii) the budget for the coming year.

Types of budget

The federal budget or the provincial budgets can be of three types.

(a) **Balanced budget.** A balanced budget is that in which the tax revenues of the government is exactly equal to the total expenditures of the government.

(b) **Surplus Budget.** If the tax revenues of the government are higher than its development and non development expenditures, the budget is named as surplus budget.

(c) **Deficit Budget.** In case the development and non development expenditures of the government exceed its revenue, the government has a budget deficit.

Preparation and Approval of a Budget.

In Pakistan, the budget is generally presented in first or 2nd week of June every year. The budget is prepared on receipts of estimated income and expenditure from various departments of the government. The budget is presented by the finance minister in the National Assembly which after amendments is approved for implementation in the next fiscal year.

The Federal Budget consists of two components:

(a) The Revenue Budget and (b) The Development Budget

The revenue budget is prepared by the Finance Division in collaboration with the various administrative ministries/divisions of the Federal Government. The administrative ministries send their requirements of funds to the Finance Division where they are mutually discussed and tentatively finalised for inclusion in the budget proposals.

The development budget, on the other hand, is prepared by the planning and development division in collaboration with the Finance Division, other administrative divisions/ministries and the provincial governments. For this purpose, the planning and development division circulates guidelines regarding resource availability as well as plan and national priorities and strategies to the Federal Ministries and divisions as well as to the provincial governments for submitting their proposals for inclusion in the national budget. The proposals received by the P&D division are then finalised in consultation with the Finance Division and the other concerned ministries and divisions. A similar exercise is carried out at the provincial level by the planning and development departments and the proposals finalised are then forwarded to planning and development division for incorporation in the federal development budget.

The budget proposals as developed by the finance and planning and development divisions are then consolidated in the federal budget which is further discussed in the meetings of the Priorities Committee and Executive Committee of the National Economic Council. The budget as cleared by the executive committee of the National Economic Council and is then submitted to the National Economic Council for approval. Thereafter the budget is presented to the National Assembly for consideration and approval.

3. FEDERAL BUDGET OF PAKISTAN

I. Main sources of revenue budget

(a) Tax Revenue

1. Tax on income, profit and wealth

It is levied on the income, profit and property of the individuals and businesses. These taxes are levied at different rates for different income groups and property owners. The rate increases with the increase in the level of income and property. This is called progressive taxation and aims at putting a relatively greater burden of these taxes on the well to do sections of the society. The Wealth Tax Act has been repeated in Pakistan in 2003-04.

2. Taxes on goods and services

(a) Excise Duty. The central excise duty, the second major source of revenue is being levied on the production of selected industries in Pakistan. It has also been levied on the services provided by hotels, restaurants and advertisements. The industries subjected to excise duty are those which have enjoyed tariff preference and attained reasonable stability in the market.

(b) Sales Tax. It is an important source of income with a substantial potential for future growth. It is levied on the sale price of goods produced in Pakistan. The rates of sales tax vary with the nature of commodity. While luxury goods are taxed at higher rates, the essential goods like milk, butter, vegetables, sugar, tea, soap etc. consumed by lower income groups are either exempted from sales tax or are taxed at lower rates.

(c) Surcharge. The difference between the maximum sale price and the production cost/average import price of petroleum, natural gas is realized by the Government. The surplus realized is a source of revenue which can also be used to iron out fluctuations in the market prices of these essential goods.

3. Custom duty

The tax on the import and export of commodities in known as custom duty. It is an indirect tax and a major source of revenue. The rates of custom duty vary with the nature of commodity and the government policy. The luxury and non-essential goods are taxed at a higher and progressive rate in order to discourage their imports. The import of essential consumer goods, industrial saw materials and machinery are taxed at low rates.

(b) Non-Tax Revenue

Besides taxes, the Federal Government also obtains revenue from the following non-tax sources.

(1) Income from property and enterprises. The Government receives income from the owned land, forests, mines, canal water and various public enterprises.

(2) Profits from post office and T&T Department. The Government has also been receiving income from its Post Telegraph Department. Since the budget 1998-99, however, T&T along with WAPDA and OGDC have been taken out of the Federal Budget and asked to do self-financing.

(3) Trading profit. The profits earned by Pakistan Trading Corporation are transferred to the Federal Government to add to its revenue.

(4) Interest and dividends. Interest receipt is the most important head in the non-tax revenue. The interest and the dividend from investment received from various corporations and the nationalized banks are the major items under this head.

(5) Minor heads. Other minor heads of non-tax revenue are: (a) Receipts from civil administration. (b) Minellaseous – Passport fee, copy right fees etc.

II. Main heads of current expenditure

(1) **Civil administration.** This includes current expenditure on various civil departments of the Federal Government.

(2) **Defense.** The expenditure on the maintenance and operation of defense services.

(3) **Law and order.** The expenditure on maintenance and operation of police and courts for maintaining law and order and administration of justice.

(4) **Community social and economic services.** The Government performs various community, social and economic services for the welfare of the people in the country. The current expenditure on roads, railways, education and health, water supply, broadcasting, transport and communication etc. fall under this category.

(5) **Subsidies.** In order to increase production and to keep prices of essential commodities at reasonable level, Government gives financial help to the producers and distributors.

(6) **Debt servicing.** This includes payment of interest on and repayment of the principal in respect of external and interval debt of the Federal Government. This is now the most important item of current expenditures of the Federal Government.

B. The capital budget

Like the revenue budget, the capital or development budget also has the receipt and expenditure dimensions which are given below.

I. Development expenditure

Contrary to the revenue/current expenditure, the development/capital expenditures aim at investment and capital formation for building up the productive capacity in various sectors of the economy such as agriculture, industry, water and power, education and health, transport and communication, water supply and sewerage etc. etc. While the revenue expenditures are used to maintain and operate the existing farms, factories, colleges, hospitals, roads etc. The development expenditure is utilized for the development of additional farms, factories colleges, roads etc.

II. The capital receipts

The receipts in the capital budget consist of the following:

(1) **Surplus from the revenue budget.** This surplus is known as government savings and is measured as: revenue surplus/Government savings = government revenues – current expenditure. This amount is available for financing the development budget. In Pakistan the revenue budget is in deficit and therefore, there is no revenue surplus for financing the capital expenditures.

(2) **Domestic borrowing.** It consists of the following two categories.

(a) **Bank borrowing:** In this case the Federal Government borrows from the central bank which can either advance credit from the additional reserves or by printing money. This mode of borrowing increases money supply and creates inflationary pressure in the economy.

(b) **Non-bank borrowing.** The non-bank borrowing does not increase money supply and therefore may not result in inflation. It however result in enhancing the interest liability which puts pressure on the revenue expenditures in the revenue budget. The various modes of non-bank borrowing are as under:

(i) Short-term loans having a maturity of less than a year. These are called floating debt.

(ii) Medium and long-term loans having a specified date of repayment. These loans are referred to as unfunded debt and take the form of various national savings schemes and accounts.

(iii) Permanent loans called funded debt. In this case the holders of the government bonds are entitled to a specified interest but the government is not required to redeem them.

(3) **External borrowing.** This can augment the resources for development and increase investment and growth in the short-run. If the amount borrowed is not used for productivity purposes, it fails to generate sufficient additional government revenues. It can throw the country into severe and unmanageable debt servicing problems as Pakistan is facing at present.

Federal Budget 2019-20

Receipts	**(Rs. in billions)**	**Expenditures**	**(Rs. in billions)**
Tax Revenue	5,822	***Current***	6,193
Non Tax Revenue	894	Interest Payments	2,891
Gross Revenue Receipts	**6,717**	Defence Affairs & Services	1,153
Less: Provincial Share in Federal Taxes	3,255	Grants / Transfers	831
Net Revenue Receipts	**3,462**	Subsidies	272
Other Receipts		Running of Civil Government	431
External Receipts - Net	1,829	Pension	421
Bank Borrowings	339	Provision for Pay and Pension	79
Provincial Surplus	423	Provision for Contingency	115
Privatization Proceeds	150	***Development Expenditure***	829
Capital Receipts - Non Bank	819	Federal PSDP	701
		Other Development Expenditure	80
		Net Lending	48
TOTAL	**7,022**	**TOTAL**	**7,022**

4. FEDERAL BUDGET FOR THE FISCAL YEAR 2019-20

Minister for Finance and Economic Affairs presented the federal budget for the fiscal year **2019-20** on April **27, 2018** in the national assembly. The Finance Minister articulated the following main elements of the budget strategy.

1) Building an economy that is not dependent on others except through trade and investment based on competitive advantage and market consideration.
2) The private sector will play a major role and shoulder the largest burden of economic functions markets would however be regulated to ensure competitive environment.

5. AN EVALUATION OF THE FEDERAL BUDGET FOR THE FISCAL YEAR 2019-20

The Budget 2019-20 has the following salient features:

1. The total outlay of budget 2019-20 is Rs 8,238.1 billion. This size is 38.9% higher than the size of budget estimates 2018-19.
2. The resource availability during 2019-20 has been estimated at Rs 7,899.1 billion against Rs 4,917.2 billion in the budget estimates of 2018-19.
3. The net revenue receipts for 2019-20 have been estimated at Rs 3,462.1 billion indicating an increase of 12.8% over the budget estimates of 2018-19.
4. The provincial share in federal taxes is estimated at Rs 3,254.5 billion during 2019-20, which is 25.7% higher than the budget estimates for 2018-19.
5. The net capital receipts for 2019-20 have been estimated at Rs 831.7 billion against the budget estimates of Rs 443.1 billion in 2018-19 reflecting an increase of 87.7%.
6. The external receipts in 2019-20 are estimated at Rs 3,032.3 billion. This shows an increase of 171.2% over the budget estimates for 2018-19.
7. The overall expenditure during 2019-20 has been estimated at Rs 8,238.1 billion, out of which the current expenditure is Rs 7,288.1 billion.
8. The expenditure on General Public Services is estimated at Rs 5,607.0 billion, which is 76.9% of the current expenditure..
9. The development expenditure outside PSDP has been estimated at Rs 85.8 billion in the budget 2019-20.
10. The size of Public Sector Development Programme (PSDP) for 2019-20 is Rs 1,613 billion. Out of this, Rs 912 billion has been allocated to provinces. Federal PSDP has been estimated at Rs 701 billion, out of which Rs 348.2 billion for Federal Ministries/Divisions, Rs 348.2 billion for Corporations, Rs 5 billion for Earthquake Reconstruction and Rehabilitation Authority (ERRA), Rs 17 billion for Relief and Rehabilitation of IDPs, Rs 53 billion for Security Enhancement, Rs 5 billion for Prime

Minister's Youth Skill Development Initiative, Rs 2 billion for Clean Green Pakistan Movement/Tourism, Rs 1 billion for Gas Infrastructure Development Cess, Rs 48 billion for Merged Areas of FATA 10 Years Development Plan and Rs 24 billion for Pakistan Sustainable Development Goals (SDGs) and Community Development Programme. The development expenditure outside PSDP has been estimated at Rs. 180.2 billion in the budget 2018-19, which is higher by 18.4% than budget estimates 2017-18.

11. To meet expenditure, bank borrowing has been estimated for 2019-20 at Rs 339 billion, which is significantly lower by Rs. 688.7 billion than revised estimates for 2018-19, reflecting decrease of 75%.

12. **Relief to low income / fixed income groups.**

Ehsaas - A new Division of Poverty Alleviation and Social Safety has been established to design and implement social safety programmes in the country. The beneficiaries of *Ehsaas* programme are extreme poor, orphans, widows, the homeless, the differently abled, medically challenged, and the jobless.

1. A new ration-card scheme shall provide nutritious food to 1 million deserving people
2. Special nutritious food will be provided for infants and mothers.
3. 80,000 deserving poor to be provided interest- free each month.
4. 6 million women to get stipends in their saving accounts and increased access to mobile phones.
5. 500 *Kifalat* centres to be provide online access to free courses to women and children
6. Wheelchairs, hearing aids and related provisions shall be provided to differently abled persons.
7. Special incentives will be provided for parents to send their children to schools in lagging districts.
8. Work on build 'Ehsaas homes' for the elderly has started.
9. BISP under Ehsaas programme is using unconditional cash transfer intervention with Rs. 5,000 per quarter to 5.7 million poorest of the poor families, with an annual budget of Rs. 110 billion. Keeping in view current inflation level, government is going to enhance the quarterly stipend from Rs 5,000 to Rs. 5,500. National Socio-economic targeting data is being updated and expected to be completed by May 2020 with coverage of 32 million households and 200 million population. 3.2 million children of BISP beneficiary families in 50 districts are receiving conditional cash transfer of Rs.750 per quarter helping government to reduce the drop-out ratio. Expansion to further 100 districts is planned. Government plans to enhance stipend amount for girls from Rs. 750 to Rs. 1,000 from the next year.

Sehat Sahulat - *This* program is a health insurance scheme for the poor. The recipient of this scheme is entitled free of charge healthcare to indoor health care services worth Rs.720,000 per year from any of the 270 selected hospitals across Pakistan. As a first step, the program has been launched in 42 districts of Pakistan addressing the health needs of 3.2 million poor families. The program shall be gradually expanded to cover 15 million poor and vulnerable families in all districts of Pakistan which includes all families of merged districts of Khyber Pakhtunkhwa, District Tharparkar and disabled individuals and their families.

Weak areas of the budget:

(1) **High rate of inflation.** The overall inflation is expected to increase during next year to double digit. Inflation at a very high level is harmful for the economy. It results in inefficient resource allocation and reduces real growth. Moreover it adversely affects income distribution, balance of trade, exchange rate and the rupee cost of foreign debts.

(2) **Budget deficit.** The Government is facing budget deficit which is proposed to be covered by domestic and external borrowing. The increase in the amount of borrowing will increase the problem of debt servicing which already is a serious problem for the country. The budget also provide for bank borrowing to cover a part the deficit.

(3) **Increase in current expenditure.** The allocation for current expenditure is increasing over the years. It calls for fiscal discipline to have less dependence on borrowed money to meet this heavy expenditure.

(4) **Revenue Collection.** The revenue collection has been estimated at **Rs. 6,717** billion. Considering the past historical experience and the fact that no meaningful widening of the tax base is proposed the target seems to be over ambitious.

(5) **Health and Education Sectors.** These important sectors generally get too low budgetary allocations. In the current budget an exception is reported to have been made by increasing the allocation for these sectors. It need to be emphasized that the allocation for these sectors would not face a cut in case of shortfall in the availability of resources. If the nation is to grow and prosper, the expenditure on education and health sectors must increase.

(6) Besides bank borrowing of **Rs. 339** billion, budget relies on Rs. 1,829 billion of external receipts.

(7) **Reliance on indirect taxes.** There is increased reliance on indirect taxes for the collection of revenue. Heavy reliance on indirect taxes will not only fuel inflation but also increase economic disparity.

6. PROVINCIAL BUDGET

The provincial budget like the federal budget has two separate sections (1) The Current Budget and the (2) The Development Budget. The heads of income and expenditure of the provincial governments are different from that of the federal. The main heads of revenue and expenditure of the provincial government are as under.

(1) **Provincial tax receipts.**

(i) **Share in Federal divisible taxes.** Provinces get a share in the Federal divisible taxes based on a multiple criteria of population 82%, Poverty 10.3% Revenue generation / collection 5%, and inverse population density 2.7%, as agreed in the 7th NFC Award announced in the budget 2010-11. Following the multiple criteria the Provincial Share turn out to be as follows:

Punjab:	51.74%
Sind:	24.55%
KPK	14.62%
Balochistan	9.09%

(3) Income from civil administration and other functions

(B) Non-Development Revenue Expenditure

The non-development revenue expenditure of the provinces is allocated under the following heads.

- General Public Services
- Public Order and Safety Affairs
- Economic Affaires
- Environmental Protection
- Housing and Community Amenities
- Health
- Recreational, Culture and Religion
- Education Affairs and Services
- Social Protection

(C) Capital Budget of Province.

(A) General Capital Receipts. The capital budget of a province of Pakistan has the revenue as well as the expenditure side. The main heads of capital receipts are (1) Budgetary support loans received from the Centre (2) Extraordinary Receipts (3) Public Debt and (4) Recoveries of Loans and Advances, Bank financing for commodity operations.

(A) Capital Expenditure of Provincial Government. The capital expenditure is divided in two parts (1) Non-Development Capital Expenditure and (2) Development Budget.

1. Payment principle portion of domestic and foreign loans, intended capital investments. Repayment of commercial bank loans.
2. **Development Budget.** The main heads of expenditure of the Development Budget are: (1) Agriculture (2) Rural Development Programme (3) Industries and Minerals (4) Water (5) Communication (6) Physical Planning and Housing (7) Education and Training (8) Information, Culture and Tourism (9) Health (10) Social Welfare (11) Man-power training.

SPECIMEN OF PROVINCIAL BUDGET AT A GLANCE

Classification	Budget 2010-11	Budget 2011-12	Budget 2012-13
General Revenue Receipts	655,699,097	667,441,763	780,674,805
Current Expenditures	434,749,818	467,993,236	532,859,871
A-Net Revenue Account-Surplus (+)/Deficit (-)	**220,949,279**	**199,448,527**	**247,814,934**
Current Capital Receipts	35,315,192	2,804,052	15,558,620
Current Capital Expenditure	54,557,766	48,186,602	55,039,484
B-Net Capital Account-Surplus (+)/Deficit (-)	**(19,242,574)**	**(45,382,550)**	**(39,480,864)**
C-Surplus for Development (A+B)	**201,706,705**	**154,065,977**	**208,334,070**
D-ADP Financing Items			
Foreign Project Assistance	18,293,295	11,445,196	41,665,930
Operational Shortfall	18,610,000	11,397,000	11,487,514
Public Account	--	--	30,000,000
	(316,705)	48,196	178,416
Total Resource for Development (C+D)	**220,000,000**	**165,511,173**	**250,000,000**

7. ZAKAT AND USHER AS TOOLS OF SOCIAL ECONOMIC WELL-BEING

Meaning of Zakat

'Zakat' is one of the five pillars of Islamic Faith. It is the community's share in the produced wealth. When this share is paid for the welfare of the society, it is then purified. **The word 'Zakat' means that which grows, improves or purifies:** When a person spends a part of his produced wealth for the welfare of others, he then attains goodness. This aspect of 'zakat' is described in Sura-al-Taubah in the following words.

"Take alms (zakat) out of their property thou would cleanse them and purify them thereby".

Assessment of Zakat

A Muslim who possesses minimum of 7.1/2 total gold or 52-1/2 total silver or its equivalent cash money is a Sahib-e-Nisab Muslim.

Zakat is paid by Sahib-e-Nisab Muslims on visible or invisible possessed wealth such as land, agricultural goods, cattle, machinery, property shares, bonds, currency, rent profit, gold, silver etc. etc., Zakat is levied @ 2-1/2% on gold, silver and on the profits of the trade. It is 10% on land produce irrigated by natural sources and 5% on land produce irrigated by man made sources of irrigation like tubewells, lands etc. (**usher**).

Beneficiaries of Zakat

There are eight heads of expenditure for zakat. The beneficiaries of zakat are;

1. The poor.

2. The needy who are helpless.
3. For payment of salaries to the staff employed for collection of zakat.
4. Payment to the converted Muslims.
5. Payment of slaves for freedom.
6. The debtors who are unable to pay the debts.
7. The traveller who becomes penniless.
8. Payment to Muslims for the Holy War.

According to the Holy Quranic Verse, "Zakat is only for the poor and the needy and those employed to administer it and to those whose hearts are made to incline (convert) and to the captives and those in debt and in the way of God and for the travellers.

Moral, Social and Economic significance of Zakat.

1. **Moral Significance.** In moral sphere, the payment of zakat by a Muslim washes his greed for wealth.
2. **Social significance.** In social sphere, it makes the rich alive to removing poverty from the society.
3. **Economic significance.** The importance of zakat and usher for the economic well being of the community is briefly discussed as under:-
   (*i*) **Narrows down difference in income.** Zakat is on income which is taken from the rich and is paid back to the poor and the needy for raising his standard of living. Zakat, thus, narrows down differences in income between the rich and the poor.

   (*ii*) **Means of livelihood.** Zakat is a fund which is utilized in providing means of livelihood to the poor and the needy according to the professional skill, individual aptitude.

   (*iii*) **Brings out hidden wealth.** The hoarded wealth of the individual is also subject to zakat. The owner of the hoarded wealth will thus be motivated to bring out hoarded wealth and use it at for productive purposes.

   (*iv*) **Expenditure on consumption.** Zakat encourages and stimulates expenditure on consumption goods both by the owners of wealth and the recipient of zakat fund. The rise in aggregate demand for goods and services increases investment and employment in the country.

   (*v*) **Elimination of class conflict between the haves and have nots.** In all muslim countries there exists a class conflict between the rich and the poor sections of the society. The gulf between the haves and the have nots can be narrowed down with the revival of the institution of zakat.

   (*vi*) **Social security.** Zakat fund provides social security to the unemployed persons in the country.

   (*vii*) **Social welfare centres.** The provision of social welfare centres like schools, hospitals, old houses, handi crafts centres are constructed with the help of zakat fund. These centres provide social welfare to the community.

(viii) **Pleasure of God.** Zakat is paid to seek the pleasure of God. It therefore encourages to work more, to produce more and to pay more zakat and so earn more for the pleasure of God.

8. DIFFERENCE BETWEEN ZAKAT AND A TAX

Zakat is fundamentally different from tax. The main points of differences between them are as under:

1. Zakat is paid by Muslims not only on savings but also on other property possessed by them. Tax on the other hand, is generally imposed on income.
2. Zakat is paid by Muslim members of the community. Tax is paid both by Muslims and non Muslim members of the community.
3. The payment of zakat is a form of worship or a religious duty. It is paid to seek the pleasure of God. Tax is a compulsory payment under the orders of the government.
4. Zakat is proportional and is charged on all types of wealth @ 2-1/2%, mines 20% irrigated land 5%, unirrigated land 10%. These rates have been determined by the Holy Quran. A tax, on the other hand is determined by the government of the country. These can be changed from time to time according to the needs of the country. The income tax is progressive in nature.
5. The beneficiaries of zakat are fixed by Holy Quran. (8 beneficiaries) and cannot be revised. Tax expenditure can be changed or modified as required by the Government of the country.
6. Zakat is spent to meet the financial needs of the poor, the needy, the slaves, the travellers etc. etc. The revenues collected through tax is used to meet the development and non development expenditures of the government.
7. There is no rebate in the payment of zakat. In case of tax, rebate and concession are allowed on certain investments.
8. Since zakat is one of the five pillars of Islam, therefore it cannot be evaded by a Muslim. Tax is generally evaded by presenting false accounts by the tax payers.
9. Zakat is an enemy of hoarded wealth. Under modern taxation system, no tax can be levied on hidden wealths of the individual as it cannot be easily unearthed by the government.

9. USHER

Usher is an obligatory charge on the agricultural produce. It is levied and collected from Muslim land owners. The land owners whether they are grantees, allottes, lessees, lease holders will pay 'Usher' on their agricultural produce. However, the persons who are eligible to receive 'Zakat' are exempt to pay 'Usher' under Shariah. The landowners whose produce from the agricultural land is less than 948 kilograms of wheat or its equivalent in value in the case of other crops, are also excluded from the compulsory charge of 'Usher'.

Rate of Usher. The Zakat of the produce of the land collected from Muslim land owners is named as 'Usher'. The rate of 'Usher' is one-tenth of the produce in case of irrigated land and one-twentieth if land is irrigated by rainfall. Usher is the first charge on the produce of land and is to be collected in cash only.

Usher may not be considered merely as a land tax. It is a levy on the produce of land and its payment is ordained by God. The Holy Quran says, "O believers! Spend in the way of Allah the best portion of wealth you have earned and of that we have produced from you from the earth. (2:267)

Use of Usher. Usher revenue is collected and distributed to the poor of the society. The payment of usher is not out of mercy and kindness for the needy persons. It is a moral obligation and religious duty of every land owner to pay usher so that the needs of the poor are adequately met. If the rich are not doing their duty to pay this compulsory levy, Allah will take them to task on the Day of Judgment. Usher, thus, is a source of transferring wealth from the rich to the poor for fair distribution of income and welfare of the poor section of the society.

10. DEFICIT FINANCING IN PAKISTAN

What is deficit financing?

When a government spends more than what it currently receives in the form of taxes and fees during a fiscal year, it runs into a deficit budget. When the budget deficit is financed by borrowing from the public and banks, it is called deficit financing.

There is no precise definition of the term deficit financing. It is a method used to finance the overall or net budget deficit. Deficit financing is said to have been practiced when the **expenditure of the government both development and non-development exceeds its current revenue and capital budget and the deficit is met through government borrowing.**

Deficit financing is an important source of capital formation in the developed and under developed countries of the world. In advanced countries, the newly created money is used to finance public investments which increases economic growth. The government invests borrowed money in improving the quality and reliability of infrastructure i.e., railways, roads, air service, social overheads such as schools, hospitals etc. The deficit financing is mostly employed to boost up economic activity in the private sector, raising effective demand for goods and services, increasing employment opportunities etc., etc.

In developing countries, the governments are faced with persistent deficits in the budgets. They are liberally using the delicate tool of deficit financing for paying back the domestic and foreign loans, meeting the government consumption expenditure etc., Pakistan, here, is no exception to it. It has **persistent huge** budget deficits and has been resorting to deficit financing since **1950's.**

Reasons for deficit financing in Pakistan. The main reasons for resorting to deficit financing in Pakistan are as under:

(i) **Rise in government expenditures.** As the years pass, there is a rapid increase in the government's current expenditure both development and non-development. It has not been able to meet its expenditures from its revenues.

(ii) **No rule based fiscal policy.** There is no effective rule based fiscal policy in the country. Fiscal indiscipline has resulted in the rise of public debt.

(iii) **Fiscal deficit.** Fiscal deficit is indicative of an unhealthy position of the country's finances because it increases dependence on domestic and external borrowings. During 2007-08 deficit was quite high at 7.3% of GDP. As a result of continuous efforts by the government to contain expenditures and to increase revenue, the deficit declined to 6.8% in 2011-12. During 2012-13 (an election year), however the deficit has went up to about 8.8% of the GDP. In the Budget for 2018-19, overall fiscal deficit of Rs.1,890.2 billion is targeted which is 4.9% of GDP.

(iv) **Low savings.** The people in Pakistan are consumption oriented. Due to high propensity to consume, the domestic saving rate of about **7.5%** of GDP is very low. As such the Government is compelled to use deficit financing as an instrument to cover the receipts expenditures gap.

(v) **Rapid population growth.** The rapid rate of population growth **(2.4%)** is swallowing up whatever little economic progress is made. The Government is anxious to speed up the economic development in the shortest possible period of time and is using the method of deficit financing.

Sources of Financing Deficit

There are three methods or sources which are used to finance budgetary deficits in Pakistan. Each method of financing has its own macro economic implications which are discussed in brief.

The methods of deficit financing are:

(1) Bank borrowing	Domestic Borrowing.
(2) Non-bank borrowing	
(3) External borrowing.	

(1) Bank Borrowing

The Government meets the deficit in budget by borrowing from the Central Bank of the country in two ways: (1) The Central Bank (SBP) issues new currency notes in the amount borrowed by the Government (2) The Government draws upon the cash balances of the past for meeting the budget deficit. The effect of deficit financing through bank borrowing is that it increases money supply in the country and generally creates inflationary pressure in the economy.

(2) Non-bank Borrowing:

The government of Pakistan is also financing fiscal deficit through non bank borrowing. The funds to meet the deficits in the budget are mobilized through the sale of government. Treasury Bills, Short Term Federal Bonds, Defence Saving Certificate etc. If there is a continuous rise in borrowing through this source, it creates inflationary pressure in the economy, increases domestic interest rates, discourages private investment in the country.

(3) External Borrowing.

The persistence of large fiscal deficits has forced the government of Pakistan to borrow from overseas. The total foreign debt burden has gone up to $74.20 billion at end March 2019. The initial impact of borrowing is that it adversely affects the exchange rate. The balance of trade deteriorates. There is also flight of capital from the country. On average, external financing of budget deficit remains one fourth of total financing in Pakistan.

WORKING OF FISCAL DEFICIT AND FINANCING BUDGET 2019-20

(Rs. in billions)

Working Deficit		Financing of Deficit	
A) Federal Revenue (net)	3.462	**Gross External Loans**	3,032
B) Total Federal Expenditure (i+ii)	7,022	**Less Repayments**	1,204
i) Current Expenditure	6.193	Long Term Foreign Loans	1,095
ii) Development and Net Lending (a+b+c)	829	Short Term Foreign Loans	108
a) Federal PSDP	701	**i) Net External Financing**	1,829
b) Other Development Expenditure	80	**ii) Domestic Financing**	
		(a+b+c)	1,308
c) Net Lending	48	**a) Bank Financing**	339
C) Federal Deficit (A-B)	-3,560	**b) Non Bank Financing**	819
Estimated Provincial Surplus	423	Public debt	583
		Public Account	237
		c) Privatization Proceeds	150
Overall Fiscal Deficit	-3,137	**Total Financing of Deficit (i+ii)**	3,137
% of GDP	*-7.1%*	***% of GDP***	*7.1%*

Is deficit financing a useful weapon?

Deficit financing is a delicate fiscal weapon for stimulating economic development. If it is wisely used, it has the following beneficial effects on the economy.

(i) If mobilizes additional resources for economic development.

(ii) It helps in utilization of unutilized and under utilized resources of the country.

(iii) It helps in building up social and economic overheads.

(iv) It helps in ensuring higher level of employment in the country by productive use of resources.

Adverse Effects of Deficit Financing.

(i) The effects of deficit financing on the economy depends upon the method for which it is financed. When the government borrows funds, it competes with the private business borrowers for funds. The additional demand for funds raises interest rate in the money market. As a result, thereof, the **private investment is depressed.**

(ii) In case the deficit financing is financed by printing of notes by the central bank, it creates **inflationary impact** on the economy, which (a) discourages foreign investment (b) reduces exports (c) increases imports (d) increases inequality in the distribution of income (e) lowers saving rate in the economy and (f) encourages wasteful expenditures.

How to reduce inflationary pressure of deficit financing?

Deficit financing creates inflationary pressure in the economy. If the time lag between the injection of created money into the economy and the completion of development projects is long and the extra demand for goods is not matched by additional output, there is greater inflationary pressure in the economy. In case, the time lag is short, there is then a lesser inflationary effect on the economy. The economists recommend following measures for minimizing the inflationary potential of deficit financing:

1. **Proper import and export policy.** A country should frame its import and export policy in such a way that the supply of essential commodities does not fall and they are provided at reasonable prices in the country.

2. **Control on the supply of commodities.** The inflationary pressure generated by deficit financing can also be reduced by having an effective control on the supply and prices of essential commodities.

3. **Proper allocation of scarce resources.** The rise in prices generated by deficit financing can also be controlled by proper allocation of scarce resources of the country. The objectives of development, the priority of the projects, the combination of factors should be carefully planned. The scarce resources, in no case, should be wasted on un-productive and wasteful consumption.

4. **Fiscal policy.** The inflationary rise in prices can also be controlled or minimized through an anti-inflationary fiscal policy. If a government increases the rates of taxes on luxury goods, reduces its own non essential expenditure, introduces compulsory saving schemes etc., the magnitude of the inflationary pressure can be reduced.

5. **Monetary policy.** An effective monetary policy can also go a long way in minimizing the inflationary pressure of deficit financing. A government can enforce such monetary measures which discourage the non-essential private investment and encourage the expansion of essential investment.

Summing up, the use of deficit financing for economic development may be likened to fire which if unregulated produces havoc, while regulated, it gives light and warmth.

QUESTIONS

1. What is fiscal policy? Discuss the role of fiscal policy in economic development of Pakistan.
2. What are the main heads of revenue and expenditure of the Federal Government of Pakistan?
3. What is Federal Capital Budget? Describe in brief the main sources of revenue of the Federal Government of Pakistan and its main heads of expenditure.
4. What are the salient features of the Federal Budget of Pakistan for the year 2019-20.
5. Briefly evaluate the Federal Budget for the year 2019-20.
6. Discuss in brief the federal tax structure of the Government of Pakistan.
7. "Zakat and Usher are very important tools of economic development. Discuss this statement.
8. Discuss the role of deficit financing in a developing country.
9. **What is deficit financing? Why deficit financing was restarted to in Pakistan?**

Short Answer Questions

Q.1. What is the overall fiscal deficit as % of GDP in the budget for 2019-20?

Ans. **7.1%** of the GDP

Q.2. Give the real GDP growth in 2018-19 in Pakistan.

Ans. Real GDP grew by 3.29% in **2018-19**.