

# Economy in light of budget

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THE articles by Sultan Ahmed and Shahid Kardar in the editorial pages seem to ignore the cardinal fact that any budget is indicative of marginal and not structural changes. Both of them have lamented on age-old weaknesses of Pakistan's economy and its budgetary mechanism.

We should realize if we are realistic that structural changes in Pakistan's economy can only be brought about by the replacement of the existing policy-making elite by a group which is less western, far more dedicated and sensitive to the poor. Budgetary changes are inherently marginal and in the existing socio-economic set-up, there can be only marginal changes.

An economy, like a coin, has two sides — one side is financial and the other is real. Normally they are two sides of the same thing, but often they present a different picture. In 2002-03, the financial side has done extremely well whereas the progress on the real side is tainted. But it is important to analyze the situation from these two different sides, which are inherently connected in order to reach a balanced conclusion.

The financial side has been boosted by an avalanche of remittances, which increased from one billion dollar in 2000-01 to two billion dollar in 2001-02 and now over four billion dollar in 2002-03. It is wrong to attribute the entire increase to 9/11 and subse-

system and punishing good borrowers to accommodate for the losses on non-performing loans.

The spread has come down to six per cent, not because of any improvement in the efficiency of our banking system or reduction in the size of the non-performing loans (they have actually increased). The banks are flushed with money and cannot find borrowers. The advertisements for borrowers has reached the absurd limit of inducing people to go for holidays on borrowed money which any prudent person should not do.

The unusual financial beacon is the low inflation rate despite an increase in money supply. The consumer price index during July 2002 to April 2003 increased by only 3.3 per cent whereas money supply

a 30 per cent increase in high value added items like bedwear, knitwear, towels and readymade garments whereas increase in low value added item like cotton yarn and cloth was only three and 16 per cent, respectively. The increase in exports has been caused by a rise in value added items and a substantial increase in non-traditional items.

Unemployment figures in Pakistan are a foggy area, because there are no reliable statistics on changes in employment. In developed countries, there is unemployment compensation. When the figures of unemployment compensation rise, the unemployment is deemed to have increased.

In developing countries like Pakistan there is no such mechanism. It is not correct to compare unemployment in Pakistan with that in Germany and France because in these countries unemployment is rising despite declining population whereas in Pakistan the main cause of rising unemployment is new entrants to the labour force. The Economic Survey 2002-03 shows a fixed rate of unemployment at 7.82 per cent for the last four years. Neither the level nor the fixity of this figure is credible.

The most important measure of real economy is the productivity. Growth rates among nations vary according to the differentials in their productivity rates. The US economy has grown faster than EU economies because of a higher rate of productivity.

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and increased insecurity among Pakistanis in the western world. The rate of increase from the UK, US and Middle East is almost the same.

Remittances have increased primarily because of a better rate of return on financial assets in Pakistan, as money everywhere, especially in an age of Internet transmitted information, flows to centres of highest returns. The weighted average return on National Saving Schemes (NSS) is 8.5 per cent and after deducting 3.4 per cent on account of inflation, the real rate of return is above five per cent. The real rate of return on corresponding Certificates of Deposits in the US is less than two per cent.

The second magnet is the stock exchange in Pakistan, which has outperformed all other stock markets of the world. In case of stock exchange, the sea flow of remittances is causing a self-perpetuating increase. As the remittances increased, they went into stocks and when stocks became more bullish, they attract more remittances. It is a textbook case of circular causation of an economic phenomenon.

The second tremendous impact of rise in remittances was to increase the liquidity in the economy. Interest rates have fallen across the board.

The rates of six-month and 12-month treasury bills fell from 15.4 per cent and 16.0 per cent in July 1998 to 1.65 per cent and 2.6 per cent in April 2003. Hence, the government can borrow more at cheaper rates and the burden of domestic debt went down from 48.4 per cent in June 2002 to 4.1 per cent of GDP in March 2003. In this short period of time, it is a substantial decline.

The most welcome change was the sharp fall in the weighted average lending rate from 14.2 per cent in January 2001 to 8.26 per cent in March 2003, a fall of six percentage points. Needless to say that a fall in lending rate leads to higher investment and now also in Pakistan higher consumption of consumer durables which should not be deplored.

Let more Pakistanis own cars, motorcycles, fridges, etc. The so-called PLS rate (it is never in loss) has also fallen by four percentage points. The spread between lending and the borrowing rate, which in developed countries is between two to three per cent, was eight to nine per cent in Pakistan reflecting the inefficiencies of our banking

increased by 12 per cent and a large chunk of the 3.3 per cent increase was caused by an increase in utility rates. If they had remained stable inflation would have been in the region of 2.5 per cent. There are three macroeconomic targets of all economies: an increase in GDP, stability of prices and a decrease in unemployment.

Most policy makers are prepared to trade off higher unemployment for lower inflation because inflation inflicts an inequitable burden on all except the rich asset owners.

The measures on the real sides are GDP growth, export growth, unemployment, productivity and poverty. The GDP growth rate for 2002-2003 has been estimated at 5.1 per cent, which is much higher than the 3.2 per cent average growth for the preceding three years. Agriculture has grown by 4.2 per cent, and manufacturing by 7.7 per cent. Construction, which has maximum forward and backward linkages and is most employment-intensive grew by only 3.4 per cent.

Electricity and gas had a negative growth of 3.9 per cent; normally it should be growing at the same rate as GDP. Services sector has been shown to grow by 5.3 per cent. Normally it should grow in tandem with the commodity producing sector. Mr Sultan is not correct in stating that last year's GDP increased from 3.6 to 3.8 per cent. Actually, it has been reduced to 3.4 per cent, probably to provide a smaller base for this year's growth.

Pakistan has been striving for last many years to achieve an export target of \$10 billion-plus. Unfortunately, for the last three years, they have been falling short. This year we will cross this target by half a billion dollars. The export growth rate of 20 per cent was only exceeded half a century ago in the Korean boom years of early 1950s.

The exports have not been diversified in the sense that textiles still account for about two-thirds of our exports but there has been diversification in the sense that exports of traditional items like leather and carpets have decreased whereas exports of chemicals, engineering goods, marble and granite, cutlery and gems and jewelry — all non-traditional items have increased by more than 50 per cent although from a small base.

Even in textiles there has been more than

tural or industrial productivity. However, the subsidy of Rs 55 billion for Wapda and the KESC shows that productivity in these two organizations is not increasing. The KESC is probably the only mega-city (more than 10 million populace) electric corporation, which is running in loss. Otherwise, in mega-cities with very low transmission losses electric supply corporations are money-spinners.

The KESC can only improve with the elimination of corruption and mismanagement. Nobody will buy it in the present state. There are no indirect indicators of growth in productivity in Pakistan.

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It seems that PRSP (Poverty Reduction Support Programme) needs to be energized by higher allocations but more importantly by better implementation.

Mr Kardar is correct in stating that fiscal austerity ordained by the IMF has stifled economic growth. Our happy position on the financial front should enable us to get rid of IMF intervention because according to Nobel Laureate of 2001, Stiglitz, the IMF has a horrible record of ruining the economies of the developing world, the latest being Argentina. Sustained tutelage of the IMF can scramble Pakistan's economy.

The government needs to ensure that its economic management will continue to improve because we are not going to have another doubling of remittances. We must sustain the growth in our GDP and exports with a stable price line for continuation of the existing momentum.

At the same time, we need to pay greater attention to poverty, productivity and employment so that the figures of good performance given by the government attract acceptability.

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