The Budget in perspective

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THE tests of a good budget are: a) the extent to which it balances the books; b) its success in achieving fiscal consolidation; c) the quality of the expenditure reforms that it promotes; d) The degree to which it meets the needs of the economy to counter depressed growth symptoms; e) Its effect on the environment for growth. The basic point to argue here is that whereas the budget for 2003-04 scores reasonably on (a) and (b), it does not fare that well on the remaining tests.

I propose to discuss (a) and (d) together since the government remains a dutiful, if not overzealous, student and client of the IMF, choosing a religious-like faith in macroeconomic stability, irrespective of the cost to the economy of such a strategy.

The finance minister rightly decided not to impose new taxes or raise rates of the existing taxes. He has opted for fiscal consolidation through rationalization of taxes, which will cause an overall revenue loss of Rs. 9.8 billion to the exchequer. However, he has balked at expanding the base of GST on services to cover professionals like lawyers, because it would have brought into the net a vocal community, revenues from which would accrue essentially to the provinces, with the federal government left to face the political flak.

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programme, through its 30 per cent upward revision, is laudable, although the formidable constraint on the rapid growth of the housing sector will be the risk of default owing to the difficulty of enforcing foreclosure laws, essentially because social and cultural values would come into play; society and the courts would find the sight of a 'defenceless' poor family surrendering its shelter to a bank repulsive.

Moving to tests (a) and (d), a common refrain of government officials throughout the year was the need to bring down the budget deficit to levels permitted under the IMF programme. The preoccupation with the size of the deficit (its reduction to four per cent of GDP), irrespective of the state of the economy and regardless of reasons, is precisely the tragedy of the budgetary exercise in Pakistan today. This obsession with the IMF-imposed budget deficit target has resulted in book-keeping functions taking precedence over the much more critical and urgent requirement to simultaneously reorient and

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bearing almost the entire cost of structural adjustment.

The unfair revenue-sharing arrangement between the centre and the provincial governments has meant that the latter will receive Rs. 520 billion less than what would have come their way under the 1990 NFC Award. Moreover, none of the debt relief obtained by the federal government and the sharp decline in domestic interest rates on government debt is being shared with the provinces. As a result, a large chunk of the development programme pertaining to irrigation channels, roads, etc., that should have formed part of the provincial, and in some cases, even local government, portfolio of development schemes is being championed and executed by the federal government.

It is also instructive that the province of Balochistan has a development programme that has the same size as the allocation for MNAs and Senators.

With a large amount of slack or underutilized industrial capacity and a low rate of inflation, a moderate increase in the deficit by another Rs. 40 billion to finance public sector investments should be affordable as it is not likely to unduly disturb the inflation rate and macroeconomic stability. Nor will it unduly enhance the debt servicing costs of the government, considering that the interest rate on its bank borrowings has fallen to below two per cent. This stimulus is urgently required.

However, it is not fiscal recklessness that is being advocated, since any large injections, in the medium to long term, will have to come from expenditure reprioritization and a major shift of scarce resources from defence that has been crowdratio is expected to remain constant at 11.4 per cent, tax revenues are expected to grow by 10.7 per cent (an increase of 7 per cent in real terms), which may turn out to be ambitious if growth remains below expectations.

The concessions to traders, the raising of the threshold turnover from Rs. five million rupees to Rs. 20 million for registration under the GST regime and amnesty to those registering before September 2003 go against the grain of documentation of the economy, although it is well known that not many have registered even when the exemption limit was Rs. five million rupees.

Whereas the import duty on larger-sized vehicles has been lowered car manufacturers should still be laughing since the decision was prompted by demands from the European Union for market access and not by the desire to threaten the privileges of local assemblers through exposure to enhanced competition.

The major thrust of the budget is the support to the construction industry in general and the housing sector in particular, through downward revisions in excise duties and income tax breaks. With their strong forward and backward linkages, growth in these sectors should stimulate economic activity all round, which, along with reductions in corporate income tax by two to three percentage points, depreciation allowances on second hand equipment, withdrawal of GST on machinery for use by exportable agro-based products, reductions in duties of 259 items (essentially raw materials) and government spending on infrastructure projects should stimulate fresh investment and thereby create more sustainable job opportunities.

To this extent, the direction and the push being given in the public sector development requirement to simultaneously reorient and redirect the economy in a way that the process of growth can be accelerated. The single-minded pursuit of the objective of fiscal austerity has stifled economic growth.

The expenditure compression effort just to meet a budget deficit target is beginning to look like a mindless exercise. With poor governance and inability to right-size government, the complementary inputs required to make government productive have, inevitably, given way to the IMF's desire to adjust the deficit. Resultantly, Wapda's distribution losses are 27 per cent and that of the KESC 42 per cent, as against 18 per cent in India, 15 per cent in Bangladesh and 8 per cent in Malaysia, while the annual loss to the economy of a poor transport system is Rs. 200 billion (five per cent of GDP). For instance, expenditure on the maintenance of roads is barely 20 per cent of the required amount; according to the World Bank in 2001, although Rs. 21 billion was spent on roads, assets of around Rs. 16 billion were lost because of deferred maintenance.

Moreover, since the current strategy insists that the defence policy and its effectiveness cannot be compromised whatever the costs, it is difficult to have a meaningful debate when confronted with such a hypothesis. The financial solvency of government cannot be an objective per se. Poverty alleviation has to be an integral part of an overall strategy for economic development. Similarly, poverty reduction cannot be achieved if provinces, responsible for improving the efficiency of social services, continue to be starved of funds through a patently unjust NFC Award and the harsh budget deficit ceilings imposed by the IMF. The provinces are seemingly from expenditure reprioritization and a major shift of scarce resources from defence that has been crowding out productive investment.

In my view there have not been significant reforms in government spending and a huge problem lies unaddressed on the expenditure side. It is a big black hole and a great deal of adjustment needs to be made in this area, particularly with respect to defence-related expenditures characterized by a complete lack of transparency (it being reflected as a single live item in the budget).

The poor efficiency of utilization of government expenditures continues to be a neglected area. For the private sector competition forces improvements in cost efficiency. Governments, however, have a monopoly over expenditure, with little external or internal pressure to reduce costs. If the efficiency of public expenditures can be improved, higher growth rates can be achieved from the same savings.

Thus, the decision to raise salaries of government servants and payouts to pensioners by 15 per cent, without a simultaneous restructuring and downsizing of the public sector and the upward revision of the provincial shares in the NFC Award (now a meager 37.5 per cent), will have a crippling effect on the finances of provincial and the recently established local governments. They will be forced to cut back on developmental activities, urgently needed repairs and maintenance of infrastructure, provision of adequate medicines to hospitals and essential supplies and consumables to educational institutions.

To be concluded

The writer is a former finance minister of Punjab