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The budget, growth and poverty

OP-ED

DR AKMAL HUSSAIN

Pakistan's economy has come a long way over the last three years for which its economic managers can take due credit. Yet, Pakistan continues to be faced with financial constraints of the government and structural problems in the real economy

The government this year has announced the budget with a triumphant air. There is little doubt that the indicators for the state of finance have shown a marked improvement. The exchange rate has been stabilised, the debt-servicing burden has been brought under control, and the fiscal deficit has been reduced to a level that gives comfort to the IMF.

Whatever the role of external factors, the government deserves full credit for these achievements. However, it is important to realise that financial stability may be a necessary but is not a sufficient condition for either sustainable growth or poverty alleviation. In this article we will examine the budgetary initiatives in the context of what the government itself now admits is a challenge of the future: High GDP growth and poverty reduction.

Let us start by identifying two crucial economic relationships that may help in understanding the level and type of growth required to reduce poverty. These are: (1) The *level* of GDP growth is determined by the investment rate while (2) the *impact* of GDP growth on poverty reduction is determined by the distribution of national income.

Amidst the indicators of success in the financial sphere, it should be a sobering thought that investment as a percentage of GDP has remained at about 15.5 per cent last year. This is far below the 25 per cent level that is required to push GDP growth above the seven per cent level, so crucial for poverty reduction. It is also significantly below the investment rate of 16.8 per cent achieved during the Ziaul Haq period (1978-87) and the 18 per cent achieved during the early democratic period after Zia (1988-93).

With investment stagnating at such a low level, even the relatively low 5.1 per cent GDP growth may not be sustainable. The observed increase in the GDP growth rate from the earlier 3.4 per cent to 5.1 per cent last year is essentially due to a sharp increase in agricultural growth (4.5 per cent) associated with a good harvest and better utilisation of existing capacity in industry. Therefore the critical economic factor that will determine Pakistan's economic destiny and the welfare of its people will be the ability to substantially increase investment and hence GDP growth.

It is now well established that the higher the degree of income inequality in a country the higher is the level of GDP growth required to reduce poverty. Given the existing high inequality in Pakistan, a GDP growth rate of at least seven per cent on a sustained basis is required to make a significant dent into poverty. If the GDP growth rate is less than seven per cent and if inequality increases, then poverty can be expected to increase. This is in fact what has happened over the last few years in Pakistan.

The question is, what has the budget done this year to address the urgent need of sharply increasing investment and GDP growth? The government claims that there has been an unprecedented increase in its development expenditure (from 120 billion rupees last year to 160 billion this year). Yet the fact is that the level of development expenditure as a *percentage* of GDP is still 4.1 per cent, which is far below the historical level of seven per cent and significantly lower than what is required to stimulate economic growth. It is a case of too little rather late in the day.

Therefore it can be argued that the budget this year is not growth-oriented but is still contractionery in nature because the government is continuing to implement the IMF mantra of a further reduction in the budget deficit. Of course, even when adequate resources are devoted to stimulate economic growth the government must face the imperative of improving the institutional efficiency of the public sector so that increased development expenditure can actually lead to increased development.

When the government is constrained in terms of the scale of public sector investment, it is clearly important for the private sector investment to rise sharply if the level of GDP growth required for poverty reduction is to be achieved. Here four institutional factors constrain private sector growth, which the government is beginning to address but has so far made little progress on the ground.

These are:

(1) Establishment of law and order for the protection of life and property of citizens. The establishment of internal peace in Pakistan is to some extent related with establishing peace on the international border with India. This is why the initiative by President Musharraf earlier and more recently by Prime Minister Jamali and his able Foreign Minister Kasuri, to start peace talks with India, is an essential element in the process of Pakistan's economic revival.

(2) Developing infrastructure such as roads, railways, ports and communications would establish a framework conducive for private sector investment. While the budget has focused on this economic imperative the resources allocated for this endeavour are woefully inadequate.

(3) High electricity tariffs are adversely affecting the feasibility of new investment projects in industry and the international competitiveness of existing industrial units. The problem with WAPDA is not only the high cost of electricity generation but also the poor quality of transmission. High voltage fluctuations and periodic breakdowns play havoc with industrial units that use sensitive electronic equipment in production. Therefore the planned privatisation of electricity transmission as well as rapid progress in cheaper hydro-electric power production must be achieved.

(4) Development of high quality professionals as well as technicians is essential to enable industry to invest in productivity enhancing new technology. While the government's budget for education this year (at all levels) has substantially increased from last year to reach a level of Rs.7.6 billion it is still about 0.9 per cent of total expenditure and 4.75 per cent of development expenditure. To improve the quality and coverage of education and to reach the scale of education expenditure of South East Asian countries the expenditure on education should be 10 per cent of total government expenditure, which is over ten times the current budgetary allocation. Here again budgetary allocations bear no relationship with the scale of the problem.

Let us now consider whether the budget is aligned with the government's undoubtedly commendable policy of poverty reduction through such measures as food support programme and the provision of micro finance. According to the budget document the government is seeking to reach 1.2 million households through its food subsidy programme. There are two problems here:

(1) The level of subsidy is too low (Rs.2,400 per household per year) to enable the beneficiary households to reach even a minimum level of consumption for all household members (average household size is about seven). This comes to about Rs.11 per poor person per month, which is quite inadequate to meet a person's minimum food requirements.

(2) The number of households that this budgetary provision attempts to reach is only 1.2 million compared to about eight million households in Pakistan that are going hungry.

The government has taken commendable initiatives in supporting the Pakistan Poverty Alleviation Fund established earlier and in setting up the Khushali Bank. The former institution provides micro finance to NGOs for lending to the poor while the latter is attempting to provide micro finance directly to poor borrowers. While the PPAF has provided loans to 82,805 beneficiaries the Khushali Bank has provided loans to 75,000 poor borrowers. This comes to a total of about 158,000 beneficiaries from both institutions. In a situation where 46 million people are in need of micro finance the coverage of both these institutions together bears no relationship with the scale of the problem.

My research for the National Human Development Report shows that only 35 per cent of the poor population is borrowing money at all and of these more than 80 per cent of loans borrowed are from friends and relatives. NGOs as a whole in Pakistan are providing only one per cent of the loans borrowed by the poor in the urban areas and 0.8 per cent in the rural areas. Clearly therefore the level of funds made available for micro finance does not address the scale of the problem.

The strategic objectives of the budget (stated in the budget document) of accelerating growth and poverty reduction are laudable. However, it appears from our analysis that the actual budgetary allocations are out of sync with the stated objectives. Pakistan's economy has come a long way over the last three years for which its economic managers can take due credit. Yet, as the current budget indicates, and the growth performance last year suggests, Pakistan continues to be faced with financial constraints of the government and structural problems in the real economy. (These problems have been identified and analysed in my earlier articles in these columns). It is these problems that need to be addressed in the years ahead, if poverty is to be reduced and sustainable high GDP growth achieved.

Dr Hussain is a leading economist and author and co-author of many books