

# **BUDGET 2004-05: ISSUES AND CHALLENGES**

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Reference to be provided by Prof. Khurshid

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The budget for the Financial Year 2004-2005 to be announced today has assumed extraordinary significance because of at least four reasons:

- First this would be the second budget of the Musharraf-Jamali Government which represents a continuation of the Musharraf Military Regime (October 1999 to Nov 2002). As economic policies are still being pursued on a plank of continuity, YET the budget would be judged on the count of its response to the demand of "change" neglected for too long. Macro indicators alone can no longer carry the day. The real test now relates to what the regime can give to the people to alleviate their miseries and sufferings.
- Secondly it is being claimed that Pakistan has adopted a policy of "bye-bye IMF" from July 2004. What difference this is going to make as to our development strategy and welfare programme? Are we shedding obsession and almost single-minded dedication to macro-stabilization the IMF diktat or would continue the same strategy without the IMF flag? More fundamentally, are we moving away from debt-based growth strategy or not — that is the issue.
- Thirdly, this is the first budget after the Indian Elections. The popular disapproval by Indian electorates of the so-called 'shining India' is very relevant to our own situation. Our strategy of liberalization and privatization has been very similar to the economic reforms pursued in India. Indian reforms (1991-2003) and our own policies under the World Bank and IMF tutelage had great similarities, a few differences notwithstanding. We boast of dollars 12.5 billion forex reserves; theirs were above \$115 billion. We claim 5.5/6.0 percent rise in GDP they have crossed 8%. We had depressed common man's purchasing power by containing budgetary deficit to 4-5% they did not do so to that extent and kept their deficit pretty higher, yet this strategy failed to deliver. Indian elections represent a wake-up call for all countries blindly wedded to a strategy of liberalization, privatization, deregulation, and macro-stabilization and market fundamentalism, to the neglect of micro-economic, justice-centered and welfare-oriented dimensions of the economy. In our case the neglect of agriculture and the socio economic infrastructure on the one hand, and alarming increases in poverty, unemployment, and economic and social sufferings of the people have exposed in its true colors the real economic malaise. How the budget addresses these issues is the real challenge.
- The fourth dimension relates to imminent onslaughts of globalization, particularly, with the enforcement of WTO regime from the January 2005, just 7 months from

now. How prepared we are to face this situation? What the budget has to offer on this count?

These constitute the touchstones on which the real worth of the Budget would be assessed and not merely on familiar hype about selective macro-economic indicators.

It is in this context that I propose to highlight some of the real issues that must be addressed to by the economic managers of this country. I would, however, preface my submissions with three general observations, which are of a fundamental and institutional nature.

- First, budget-making in our country, has become the almost exclusive privilege of the executive, to the virtual exclusion of the Parliament which represents the people of the country. Other stakeholders in the economy also do not figure in. This is so because we are still framing our budgets under the shadow of the Indian Act of 1935, which institutionalized the categories of "Charged Expenditure" and "non-charged expenditure." Charged expenditure which covers sizeable gamut of governmental activity including the entire expenditure of the Presidency and a number of state organs and institutions along with the whole range of debt charges, for which the federal government is liable, is out of the control of the Assembly as it has no right to vote on them. This means that the authority of the National Assembly has been limited to charged expenditure only. (Article 81-82 of the Constitution). Moreover, the entire defence budget is turned into a sacred cow as its details are never debated or even shared with the Parliament. To cap this all the time given to the Parliament to discuss the budget is a cruel joke - it is decorative and ceremonial, to say the least. In some of the democratic countries of the world Parliament and its committees take 4 to 6 months to discuss and finalize the budget, no where less than 4 to 6 weeks. In Pakistan everything is disposed off in a couple of weeks. This amounts to virtual dis-empowerment of the Parliament in respect of its most important function - legislation and control over the national finances. The finances of the country are in the hands of an executive oligarchy.
- Secondly, budget covers the whole range of governmental activities. It also is a snapshot statement pertaining to the economic, financial, commercial, agricultural and labour policies of the Government. Unfortunately these policies are formulated in a fragmented and disjointed manner, each Ministry operating as an autonomous satellite. Hardly any effort is made to harmonize policy-making in all related areas. Not only that, in many areas, particularly those relating to conditionalities attached to foreign loans, the Ministry of Finance commits the country without proper input from other related Ministries. Hence conflicts and anomalies along with overlaps and missing gaps. Absence of more integrated and holistic approach is also responsible for many contradictions in Government policies.

- My third fundamental concern relates to the reliability or otherwise of statistics and the information on which the entire national income accounting and budgeting is taking place. Despite some visible improvement in data collection and classification there are serious flaws, in the system at all levels that cast doubt on some of the data relating to production estimates in different fields of the economy, particularly agriculture, labour and employment statistics and the entire exercise about poverty-count. Absence of alternate sources of information, independent of government control and influence is another worry. Our policy makers make mountains out of moles about percentage changes that figure in decimals, ignoring the fact that margin of error in our accounting system is so vast that makes many a claim and comparisons a mockery. Leading authorities like Oskar Morgenstern (see: *On the Accuracy of Economic Observations*, Princeton University Press) have warned against reading too much into GDP and rate of growth figures only. That is why many leading economists and statisticians suggest that unless a vast array of indicators is taken into view, real picture of the economy would remain elusive. There is a lot of truth in the suggestion that statements based on selective macro-indicators must be taken with a pinch of salt.

The extent of poverty in Pakistan is one of the critical questions we all are facing. Reliability of the data is the major issue. A recent study of the Department for International Development of United Kingdom as quoted in a consultancy report (Country Assistance Plan for 2004-2007 - Pakistan) has come up with an alarming forecast that people living below poverty level by 2010 can be 42% of the population (some 82 million people), as against the current estimates of 32.1 percent, which according to certain independent economists is an under estimation.

The recent revision of the base year for national income accounting from 1980-81 to 1999-2000 is also problematic. Revision of the base year is not the issue. Choice of a year (1999-2000) when the economy was seriously depressed for a number of reasons including sanctions imposed in the aftermath of 1998 nuclear tests is enigmatic. Change of the base year in this manner is going to distort the picture and give a colored view of the rate of change in economic variables, making comparability of the data difficult, particularly for the non professionals. Because of this one bit of statistical ingenuity a more rosy picture about GDP and per capita would emerge, which in fact would becloud the real state of affairs.

These three fundamental issues deserved to be discussed thread-bare in the Parliament and by the people with a view to adopt remedial steps planned meticulously.

As to the major pressing issues and challenges that the Finance Minister faces on the occasion of the budget I regard thorough rethink as to the one sided emphasis on macro-stabilization. This is the most important issue. This has generated false complacency and led to the neglect of some of the burning issues of the economy, like increase in poverty from 18 percent in late 1980's to over 32 percent in 2000 and after. Unemployment has also increased from around 5 per cent of the

registered labour force to near 8 percent. While both represent serious underestimation, the fact that rate of increase in the number of the unemployed is around fifty-percent within a span of five years is alarming. The problem is serious at both ends, educated-unemployment in the urban areas, and much higher unemployment and under-employment in the rural areas. Keeping the rate of inflation low at the cost of down-grading the rate of growth (2000-2002) was a part of this strategy. The rate of inflation remained depressed not because of higher output, improved flow of goods and services and better productivity, but because of low purchasing power and depressed demand via poverty and unemployment increase. This made life difficult, even miserable for almost half of the population.

We have created an elitist economy. This lies at the root of our current economic malaise. The natural result of a lopsided economic policy concentrating almost exclusively on macro-stabilization was neglect of other equally important areas of policy and performance. As an economist I realize the importance of micro-stabilization but as a professional who is not sold to 'market fundamentalism' of the IMF/World Bank brand I regard this disbalance and deliberate selectivity as responsible for most of distortions and contradictions in the economy and the miseries of the people. The basic flaw lies in our economic policy and management. Unless the new budget is prepared to shift the emphasis, we would remain in deep trouble.

In my view the focus of our policy thrust should be towards making agriculture and small and medium enterprise the center-piece of economic activity, development strategy and resource allocation. It is mind-boggling that agriculture which contributes 25 percent to the GDP, 45 percent to employment, sustains 60 percent of the population, and provide over 65 percent input to country's exports is getting less than 1 percent allocation from the Federal Budget (FY 2003-04). The total federal allocation for food and agriculture excluding irrigation was Rs. 1.175 billion, which is hardly 0.3 percent of the GDP.

Agricultural policies have been so erratic that no clear and consistent pattern emerges. Food security is conspicuous by its absence. Pricing policy for agricultural products is in a mess. The Agricultural Prices Commission recommended in 1981 an active and medium term support price policy for a dozen of crops. Support price has been pursued only for two (wheat and cotton) and that too in an erratic manner. Mostly the policy was never announced at the right time i.e. sufficiently before the sowing season. Data presented by the Ministry of Finance before the Senate Standing Committee on Finance (May 2004) shows that wheat imports were subsidized to the tune Of RS. 1.046 billion year 1999-2000 and then wheat exports were subsidized to the extent of Rs. 543 million in 2001-2002 and Rs. 3.315 billion in 2002-03 and provision made for export-subsidy in the budget for 2003-2004 to the extent of Rs. 5.1 billion while the fact is that wheat shortage become acute in 2003-04 and resulted in import scandals and price hike for the common man. There is no medium term policy of food security, of maintaining enough strategic reserves and management of stabilization funds for this purpose. Agricultural inputs are costly - power, seeds, fertilizer, pesticides and credit. Yet the Government chose to impose, under IMF dictation, sales tax on fertilizers, with the result that for a revenue of Rs. 1 billion this country lost over Rs. 6 billion as a

result of low yield due to lesser use of fertilizers only. At one time agricultural credit was provided at the rate of 17-18 percent and even now it is in the range of 14 percent while the market rate of interest is one third of this figure.

The state of small and medium enterprise is no better. The very definition of small enterprise needs to be revised. Research in many countries has shown that most effective employment creation can take place via proper incentives and facilities for SME's. In my view an enterprise that employs up to 50 persons and whose capital is up to Rs. 50 million should be treated as small enterprise and given maximum tax relief, preferably total tax exemption including GST relief for the first five years, and low fixed tax after that. There is even a need to have a separate Ministry for SME in Federal and Provincial Government to give real fillip to this sector.

Is the Finance Minister prepared to bring about such a radical transformation in our economic policies? Then only the country can move towards self-reliance, economic sovereignty and eventual poverty elimination, and not merely reduction!

Criminal neglect of the social and economic infrastructure is my next major concern. Despite skyrocketing mountains of external and domestic debts very little has gone into the expansion, new construction and even proper maintenance of whatever infrastructure was built in the first thirty years of our existence. Loans and grants worth around \$ 6 billion were received up to 1970, when West and East Pakistan were one and integrated whole. What was left of Pakistan in 1971 has received around \$ 54 billion of loans and grants between 1972-2003. How much real asset-creation has taken place during this period remains an enigma. No serious work has been done in the Planning Commission to assess that. Independent estimates suggest that not more than \$8-10 billion has gone into real asset creation, and yet the country has been burdened with over \$ 70 billion in debts, including what has been paid or is payable as interest and debt-servicing.

Lack of water for irrigation is assuming serious proportions. Big dams have been a casualty of political rancor. Small dams and water reservoirs remain a victim of neglect. Water management and upgrading of the irrigation system to get rid of huge water losses has not figured in our planning. If nothing is done on an emergency basis through an equitable water saving and management programme for the next 4-5 years, the country may be heading towards its worst economic crisis.

The state of social infrastructure is no better. Education and health are starved of resources and privatization policies in these areas have only served the interest of the wealthy elite. According to one study Pakistani students are paying in fees for 'O' and 'A' level programmes to the tune of \$ 1 billion a year, their number is second only to the students in the UK itself. The state of public education, which caters for 95% of the student population, is despicable. Allocations for education and health are even lower than the average allocations for these sectors in developing countries that belong to our level of development. In fact, over the last four years allocation for health has remained between 0.7 to 0.8 percent of the GDP and for education has fallen from 2.1 percent to

1.7/1.8 percent. Massive allocations to these Sectors and their proper utilization are the real need of the hour.

The Government is rightly concerned about liquidating its foreign liabilities. It should also be concerned about the huge debts that are breaking the backs of Provinces. These loans carry exorbitant rates of interest from 8 to 17 percent, average around 14 percent. To give just one example: the NWFP Government had acquired loans under Cash Development Loans and other Programmes between 1972-73 / 2001-2002, to the tune of 43.927 billion rupees, which have cumulative mark-up of Rs. 110.179 up to 2023 horizon? To put it differently, against a total loan of Rs. 43.9 billion they have paid upto 2001-2002 Rs. 85.230 billion and have yet to pay over Rs. 68 billion, upto 2023 if the debt is not liquidated. If this is not Shylockism, what is the name for it?

Is the Federal Government prepared to provide substantial relief to the Provinces in this respect? Is there a strategy for debt-retirement of the Provinces?

My next worry relates to another menacing aspect of our governance i.e. serious weaknesses in the entire system of plan and policy implementation, absence of appropriate supervisory and monitoring mechanisms, the virtual collapse of the delivery systems and the ineffectiveness of accountability processes. . Whatever data is appearing in the press, suggest that hardly 48.6 percent of the development allocations have been utilized in the first 9 months. The implementation machinery both at the Federal and Provincial levels is very defective and inefficient. What is being done to correct this serious weakness?

Globalization is not an unmixed blessing as the leaders and' agents of global capitalism, the Multi-National Corporations and their accomplices in NGOs are tutoring us. WTO regime is knocking at our doors. What 'has been done to prepare the economy to meet this challenge?

In the final analysis our success or failure would depend on our own competitiveness in world markets along with our capacity, with the cooperation of other developing countries, to put enough pressure on the developed countries to let the trade be fair and just and not merely free. They are subsidizing their agriculture to the tune of \$ 1 billion a day and we are being pressurized not only to withdraw subsidies but impose GST on agricultural inputs! Use of International Property Rights by the developed countries as a stick to beat others has become a global scandal. Labour and environmental excuses are being used to discriminate against the products of the developing countries primarily to protect their own industries. Better trained labour, lower production costs, improved R&D and upgrading of technology, greater concern for quality and environmental considerations, effective regional coordination are some of the policy dimensions that must be addressed at top emergency level. What is our response? According to an ABN AMRO research brief (May 2004) "The council set up to deliberate upon matters pertaining to WTO has met once (or twice at the most) in the last two years" and "that the Government has considered in the recent past an officer of the Police Service as a serious contender for the post of Commerce Secretary. The

report concludes: "In an era of technocratic specialization, the missteps underscore how out of sync with reality current policy on meeting the challenges of globalization is".

Finally I want to raise the issue of bringing the economy in conformity with the Islamic ideals, values and ethos. Islam stands for the establishment of a justice-based welfare economy, which ensures honorable living for all members of the society. Along with growth-orientation it stands for equitable distribution of income and wealth and provision of opportunities for economic effort and well being for all. Islam wants to eliminate all sorts of exploitation including Riba/interest, speculation and unethical economic behaviour. While elimination of Riba/interest and establishment of Zakat and a social security system are essential ingredients of the Islamic economic system, they are not its be-all and end-all. The objective is the establishment of a just and welfare economy. The moral and the egalitarian dimensions are its most important characteristics.

As to the promotion of interest-free banking I welcome some of the steps the State Bank of Pakistan has taken to promote Islamic modes of Banking and finance But the fundamental question is that even elimination of Riba is not feasible unless the taxation system is reformed, there is greater transparency in all economic dealings and at least there is level-playing between interest-bearing and equity-based investments and modes of finance. What is being done in this respect? Unfortunately the whole system encourages interest and taxes equity based investment. All Islamic modes of finance and investment must be given similar, if not more, tax incentives and other non-monetary facilities.

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