DAWN

Economic consequences of budgetary options

Ishrat Husain Published June 5, 2023

LET me first concede that I have great deal of sympathy with those who have been given the responsibility for preparing the FY24 Budget. We are faced with the most difficult external and domestic circumstances. Global economic conditions and geopolitical compulsions are unfavourable.

Losses from the 2022 floods are yet to be recouped. Security risks are once again heading up. Inter-institutional tensions and political fragmentation are at their peak. Per capita incomes and living standards have taken a deep dive.

It is in this context that we have to carefully examine the consequences of the two main options for formulating the budget this year.

The first option that has been followed in every election year is to provide fiscal stimulus in the name of relief to the "common man".

In the context of debt/GDP ratio of 100 per cent and debt servicing absorbing almost 80 to 90pc of the revenues the stimulus is unviable. If the prices of electricity, petroleum products, gas, fertilisers, food are kept at below their scarcity value the budget would have to bear an extraordinary brunt.

We should learn from our recent historical experiences. The caretaker government in 2008 did not pass on the rising world prices of petroleum and food to the consumers and the incoming PPP government had to approach the IMF for a bailout.

Similarly, in 2013 — a deterioration in fiscal and external indicators forced the PML-N government to seek financial assistance from the IMF.

The country was struck with a large current account deficit in the year 2018 amounting to 6pc of GDP with reserves as low as $6.7 billion. The PTI government, after some protracted delay, had to enter into an agreement with the IMF.

In 2022 the retail prices of petroleum products were frozen lower than their purchase price leading to the derailment of the IMF programme.

The lesson from these experiences is that the so-called “relief” measures do not help gain political ascendancy but do material damage to the economy with frequent recourse to external actors.

The more effective mechanism is to target the subsidies on the poor and the low middle income groups through the Benazir Income Support Programme (BISP) which has proved robust (National Socio Economic Survey, biometric identification, access to bank accounts for the recipients).

The targeting success is high and leakages are minimised. The targeted subsidies would reduce the budgetary allocation for subsidies to almost half, energy prices for industrial consumers would become regionally competitive as they would no longer subsidise domestic consumers and increased fertiliser usage by small farmers would enhance the productivity of crops such as wheat, cotton and pulses.

For quite long time FBR mobilises tax revenues by overburdening those already in the tax net. Super tax, inter-corporate dividend tax, tax on undistributed reserves and unappropriated profits are some of the tactics to achieve the targets.

It ought to be realised that retained earnings are a potent source of private capital formation for capacity expansion or new ventures in industry. To deprive the firms of this source of financing in an already investment deficient country and a depressed level of bank credit to the private sector does not augur well for economic revival.

The economy is already facing slack, cost of working capital is exorbitant, import barriers and restrictions have disrupted supply chain, exchange rate path is unknown, regulatory environment is suffocating and on top of these the tax authorities wish to add fuel to the fire. Industrial sector is already paying almost two thirds of tax collection. Any further burden would lead to production curtailment and therefore prove counterproductive to the tax target achievement.

Increase in budgetary expenditures because of the increased across-the-board subsidies and lower collection of tax revenues would further widen the fiscal deficit, escalate borrowing requirements and consequently higher inflationary pressures would affect the fixed income groups such as salaried class, pensioners, widows, etc disproportionately.

Exports would slide down accentuating the trade imbalance. In absence of a favourable business environment, FDI flows would dry up and recourse to external borrowing would become inevitable. Direct and indirect job losses would be colossal. Incidence of poverty would get aggravated.

What happens if we follow the second option of fiscal prudence and discipline which is congruent with the parameters of the IMF programme. First and foremost, we would be in a position to service our external repayments amounting to over $26bn in FY24 and perhaps consider the possibilities of debt reprofiling on the lines we did in FY2001 that reduced our debt/GDP ratio to 50pc from 100pc.

Second, as discussed above, the increased prices of utilities, fertilisers and food have to be passed on to the consumers and target the subsidies to the poor, low income groups and small farmers.

After accounting for higher allocations to BISP to make these payments the budgetary savings would be significant.

Third, the efforts to broaden tax net by bringing in 60pc of the economy — agriculture, wholesale and retail trade, transportation, construction and real estate — have to be stepped up. Details are all available but it is a matter of political determination to implement them. Use of electricity bills for traders to pay fixed rate has to be put in practice.

The data bases of Nadra and other third parties should be deployed for assessment of non-filers. Provincial governments have to be asked by the National Economic Council to revise the taxation on agriculture, urban property and left out services.

Fourth, the Triage Plan to restructure, privatise each of the 85 state-owned enterprises has been worked out in detail and is ready for implementation. This would provide a huge fiscal space to the government and cut down its borrowing requirements.

To sum up, the economic consequences of a populist budget are fraught with serious risks. On the other hand, a fiscally prudent and disciplined budget on the lines outlined above would be congruent with the IMF programme and allow us to navigate through these difficult and uncertain times.

The writer is a former governor of State Bank of Pakistan

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