|  |  |  |
| --- | --- | --- |
|  | The budget arithmetic  **By Dr Ishrat Husain** |  |
|  | Pakistan's economic growth in the last four years has been quite disappointing both in relation to the preceding four years and compared to other South Asian countries. Austerity measures to contain fiscal deficit, achieve macroeconomic stability and reduce external borrowing have squeezed the space for public sector development programme. The uncertainty and lack of direction, political instability, energy shortages, security concerns and high interest rates have played to the fear of private sector which has withheld productive investment. Consequently, total investment-GDP ratio which had reached 23 percent has declined to 13 percent. Assuming that investment ratio and the incremental capital-output ratio at an aggregate level remain at least the same we can expect about 3.5 percent average growth rate. With population growing at about 2.0 percent, per capita incomes will stagnate at 1.5 percent. Unemployment will remain high and inflation being in double digits the fixed income earners and salaried class will continue to face severe economic stress. For five years in succession and particularly in the election year this state of affair is simply unacceptable. The budget 2012-13 is critical for the medium term. It can either aggravate the damage to the economy by reckless spending and populist measures or put in place a mechanism that leads the country towards a path of resuming growth with redistribution towards the poor. This article argues for the second option and spells out the specific measures that should be adopted in the formulation of the budget 2012-13.  First the institutional framework for budget making has to be altered and the present practice of federal and provincial governments engaged in non-binding consultations should be replaced by a formal binding, integrated budgetary framework. The federal and provincial governments will have full freedom to prepare their budgets as long as they follow the parameters agreed under this framework. There should be discussion and debate in the Council of Common Interest (CCI) and once a consensus is reached the budgetary framework should be approved by the National Economic Council (NEC). This is a critical step because of the asymmetry between revenue accrual and responsibility location for expenditures. The federal government has to run deficit on its accounts while the provincial governments have to generate surplus in order to maintain manageable overall fiscal balances.  Second, there should be concerted efforts to increase revenues amounting to 2 percent of GDP (1 percent of GDP means Rs180-200 billion in absolute amounts) in the following manner:  \* Increase Provincial tax and non-tax revenue by 0.5 percent (property taxes, agriculture income tax). Sindh Revenue Board is expected to raise Rs25 billion through sales tax on 15 services in the very first year of its operation. Punjab is following the suit from July 2012  \* Raise federal tax collection by 1.5 percent through improvement in tax collection and administration, full realization of withholding taxes from agents, recovery of fraudulent input adjustments, bringing in new assesses under tax net, imposing fines and penalties on understated incomes, dividends, profits and other incomes.  In other words, the households and firms that are not contributing their due share or evading taxes should be the focus of attention. The scope for collecting this additional amount is quite large. It should be mentioned that the proposed increase in revenues is over and above the autonomous increase arising from the buoyancy and elasticity of tax revenues with respect to nominal GDP.  Third, there is a dire need to save expenditures on unproductive purposes at least by 1.3 percent of GDP through the following measures:  \* Lowering the amount of generalized untargeted subsidies saving 0.5% from the current 1.5 percent of GDP \* Imposing hard budget constraint on public sector enterprises and privatization saving another 0.5 percent \* Freeze on non-development expenditures except on education, health, security forces, judiciary 0.3 percent  These goals can be achieved if the federal and provincial budget are considered together, scrutinized rigorously and monitored regularly.  http://magazine.thenews.com.pk/upload_image/10/2507_5-14-2012_2.jpgFourth, development expenditure on energy, transport, infrastructure, social sector should be raised by 1.5 percent of GDP to complete ongoing projects that can ease the critical shortages and provide a stimulus to the economy. The original allocations should remain intact and the releases of development funds should be made promptly every quarter. Re-appropriations should be made from slow moving projects to these showing tangible progresses towards completion.   In addition, private sector should be involved in infrastructure and social sector investment projects in partnership with the public sector. This could infuse at least 0.5-1 percent of the GDP of private capital to the PSDP.  Fifth, current expenditure on education, health, law enforcing agencies and judiciary should be increased by 0.5 percent of GDP while targeted subsidies to the poor all channeled through Benazir Income Support Programme (BISP) should be raised by 0.3 percent of GDP.  Sixth, the State Bank of Pakistan should set up small and medium enterprises facility, low-cost Housing Refinance Facility and Infrastructure Finance Facility which can complement private sector equity with bank loans. Bond issues for large infrastructure projects can be attractive for pension funds, provident funds, insurance companies etc.  Seventh, the over dues and inter-company debts of energy sector should be cleared up by refinancing the stock and reducing the gap in the inflows of revenues and outflows of expenses. The steps to be taken in this respect are well known but need to be implemented. About 2500 megawatt of generation capacity can become immediately available by clearing the overdue payments of independent power producers.  The arithmetic of the above proposals, if designed and implemented faithfully, suggests that we can reduce fiscal deficit by 1 percent of the GDP. At the same time the goal of kick starting the economy through public sector development projects in partnership with the private sector, restraining the amount for unproductive expenditure, using banking in selective sectors, reigniting the energy sector, and redistributing incomes to the poor through BISP can lay the groundwork for getting the economy out of the low level equilibrium in which it has been trapped for the last four years.   It needs to be emphasised that the numbers indicated in this article are not intended to be precise but are broad ball park estimates. Only the finance managers are aware of the actual figures and the potential savings or inflows. They can use these suggestions as the starting point and refine them further. But the underlying thrust of the argument that the last four years' trend of stagnating incomes has to be reversed by boosting stimulus to public sector investment while providing income support and subsidies to the poor.  A lot of coordinated hard work in careful formulation and continuous monitoring would be required to reach these targets. There is bound to be resistance both by revenue collecting agencies and spending ministries and agencies. Political leadership at the federal and provincial governments have to lend and their full support to the finance managers in getting through this arduous and difficult process. In doing so, they can be rest assured that their political interests would no way conflict with the goals of revival of economic growth and redistribution to the poor. This strategy is better than allocating resource and jobs to individual members of the legislature. The incoming elected government whose ever it may be, will inherit an economy in a much better shape.  *The writer is the dean of the IBA and a former SBP governor.* |  |