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Budget 2011-2012: All eyes on the centre, but provinces matter too

By Ishrat Husain On Jun 5, 2011 (9:58 AM) In Business, Pakistan

KARACHI:

The budget announced yesterday did not contain any surprises and was, as usual, an accounting statement of the revenues and expenditures of the federal government.

In so far as the content of economic policies and institutional changes was concerned, it made four departures from the past.

First, the federal excise duties are going to be phased out in the next three years and a beginning has been made in this year’s budget. Second, the exemptions and concessions in the tax regime available for a wide variety of activities without any coherence are being abolished, minimising some of the distortions and mobilising foregone revenues. Third, the direct tax base was being enlarged by bringing in a significant number of potential taxpayers into the tax net through stronger enforcement—something which we haven’t seen in our long history. However, there is no estimate as to how much would be collected from this particular move. Finally, if it is really implemented, the allocations to accelerate the pace of projects that are near completion in the public sector development programme (PSDP) would bring forward some of the benefits that have been postponed for a long time. All these are welcome initiatives and if they get firmly rooted in our implementation culture, we would have made headway.

However, there are significant omissions which should have been part of the budget statement. First, there must have been an explicit declaration of a comprehensive strategy about all public sector enterprises, corporations, autonomous bodies and other entities which are to be restructured, liquidated, wound up, merged, privatised or retained. The minimisation of losses from this source can contribute to narrowing of fiscal deficit. I hope that parliament will insist upon getting this done.

Second, the investment ratio has come down so sharply that it would perhaps suffice to compensate for the depreciation and replacement of worn out and antiquated capital assets in the country. The provincial governments should be bound to use the additional resources from the divisible pool towards investment in roads and highways, irrigation systems, rural infrastructure, education, health, water supply, sanitation and urban services. The federal government has very little flexibility to do so and my apprehension is that when push comes to shove the axe will again fall upon the federal PSDP to reduce the fiscal imbalance. Lack of public investment would keep us trapped in a low equilibrium growth path for the fourth consecutive year.

This brings me to the third but the most important point I wish to make. In light of the most desirable and welcome structural shift in inter-governmental relations brought about by the 18th amendment and the NFC award, the federal and the provincial budgets should have been anchored in an integrated budget framework paper discussed, debated and approved by the National Economic Council (NEC) in which the overall resource envelope and expenditure thrust and sectoral priorities are determined first and then the responsibilities are divided and assigned to federal and provincial governments in a consistent and coherent manner.

The federal and the four provincial budgets should then be formulated and announced within the limits, parameters and the direction set by the NEC. It may be recalled that the NEC consists of all chief ministers and is presided over by the prime minister and has constitutional authority to fulfill this function.

We cannot afford to act in business as usual fashion because the armament of the 20th century we are using today is totally outdated for the economic battles of the 21st century. Our macroeconomic stability will remain at great risk if these new arrangements for policy and decision making, conflict resolution between various governments and consensus building are not in place.

What are the downside risks to the scenario depicted yesterday? The budget does not have cushion for absorbing any unforeseen exogenous shocks, whether external or domestic, as it is very tightly bound together. Any deviations from the key assumptions upon which its edifice is built upon can cause a lot of dislocation. Pakistan is prone to such shocks and God forbid if anything adverse happens during the course of the year, the budget would soon be off the mark.

Dependence upon external resources to fill in more than half of the financing gap is something we have to worry about.

The other risk factor is whether the electricity and other subsidies which have been rightly slashed by Rs200 billion compared to the ongoing fiscal year will in fact hold, or political and other pressures will force the finance ministry to relent. The one per cent (of GDP) surplus from the provincial governments did not materialise last year. Let us hope that we are lucky the second time.

The repetition of selective measures in the public sector pay and pensions without placing them in the overall strategy of human resource policy changes would hardly be beneficial either for the civil servants themselves or for the general public for whom the government employees are the conduit for access to services and redressal of their grievances. The monetisation of conveyance allowance for senior civil servants is a step in the right direction but the impact will be diluted if the overall package that will attract talented young men and women to join the civil services is not announced.

The expectations from the federal budget have traditionally been quite high but we must realise that the degrees of freedom and the space for maneuverability have shrunk substantially for the federal government. It will be the resource mobilisation efforts, the composition of expenditure, priorities and the further distribution of the provincial budgets which will make much of a difference in the realm of public sector finances and the lives of the ordinary citizens.

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