

## PRESENT BUDGET AND ECONOMIC CHALLENGES

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Pakistan Economy is confronted with serious economic problems e.g. perceived insolvency in the external account, rising debt servicing, tumbling exports and worsening current account balance which seriously jeopardized its sustainability and sovereignty as a nation. According to Economic Survey 1998-99, no such respectable targets were achieved except inflation. The signs of recovery are still far away. The past two years of stimulus of supply side medicine failed to pick up the economy substantially, and the second prescription of demand stimulus through expansionary fiscal policy under the umbrella of easy monetary policy of rescheduling of debt, low interest rate and low inflation worked less. The question is that, in current budget 1999-2000, will these policy combinations take off the economy out of deep recessionary conditions or revive the economy and restore the business confidence? This article deals the question.

Pakistan experiences tremendous growth, but could not sustain over time. The main reason of unsustainability is the dependence upon the external factors. The main external factors which are affecting Pakistan economy are: Climatic conditions, Remittances and Foreign aid. The current budget for fiscal year 1999-2000 is the reflection of dependence on external resources. (See Budget at Glance Table 1).

TABLE - 1  
BUDGET AT GLANCE (Rs. in Billions)

RECEIPTS	BUDGET
1. Net Federal Revenue Receipts:	422.9
a) Tax Revenue	356.0
Taxes on Income and Wealth	127.0
Taxes on Commodities and Transactions (Indirect taxes)	229.0
b) Non Tax Revenue	141.7
Income from Property and Enterprises	75.1
Receipts from Civil Administration and Miscellaneous	66.5
c) Surcharges	63.3

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Natural Gas	5.2
Petroleum	58.1
<b>d) Gross Revenue Receipts</b>	<b>560.9</b>
<b>e) Net Federal Revenue Receipts</b>	<b>422.9</b>
2. Net Capital Receipts:	44.1
a) Receipts	93.8
b) Disbursements	49.6
3. Extension Resources:	185.0
i) Project Aid	43.6
ii) Non Project Aid	-
4. Self-Financing of PSDP by provinces	3.9
5. Credit from Banking Sector	13.7
<b>6. Total Resources (1 to 5)</b>	<b>642.2</b>
<b>Expenditure</b>	<b>Budget</b>
7. Current Expenditure	525.9
Running of Civil Government	48.3
Defence	142.0
Subsidies	2.4
Debt Servicing	287.4
Grants	38.0
Unallocable	7.7
8. Development Expenditure	116.3
Federal Government	87.5
Federal Ministries Divisions	45.2
Corporations	38.7
Special Programmes	3.6
i) Provincial Programmes	28.8
Punjab	12.2
Sindh	6.7
NWFP	4.9
Balochistan	5.0
<b>9. Total Expenditure (7 + 8)</b>	<b>642.2</b>

Source: Budget Speech, 1999-2000 Ministry of Finance, Govt. of Pakistan.

The supporters are praising the government for presenting a tax-free budget. The opposition has expressed their concern that mini budgets are still to come. Amazingly, neither the supporters nor the members of the opposition are genuinely concerned with the gravity of the fiscal health and plight of the poor masses. But, they rather nominally concern budget as merely a "traditional exercise". This is the third budget of the present regime. Like the previous ones, this year budget is also claimed to be a tax-free, loaded with the promises of revival of economic growth, higher allocation for development, higher exports and higher investment and savings, ambitious revenue targets (unachievable like previous ones!).

First this budget is not tax-free, as the major tax doses have already been injected in the body health of the economy much before the announcement of the budget. Budget is no more an exercise of fiscal procedure and criticism. The 35% increase in POL prices since May 98, the increase of 25% in sales tax rates, and increase of 12% in electricity tariff are simple examples. Despite the fact that POL prices hit all times low to 1973 prices of 9 \$ per barrel. Where-as the government set last prices at par with the international prices on 22 \$ per barrel. As the government always claims the parity in POL prices with the international prices. But no downward trend or adjustment is ever observed in history. The upward increase in POL prices generated Rs.30 billion as excessive surcharge (whereas no excuse offered to people). Government Collected rupees Rs.73 billion as surcharge on POL only in 98-99 fiscal year. The second highest revenue source in the last year's total revenue collection. Otherwise revised tax collection target of Rs.300 billion would have been shortfall of at least 50 billion rupees. Besides this, the additional 17 billion tax burden imposed

this year as the Finance Minister admitted in post-budget press conference (Dawn, June 14, 1999).

Every time we listened to the speeches that due to the magical policies of the government, economy is put back on the track of economic growth and self reliance, the crises are over ! Every time, we listened that the problems of the poor will be redressed, the industry will be revived, the poverty will be alleviated, default loan will be recovered, more employment opportunities will be created. Despite the fact that economy did not fall as much as predicted due to May sanctions as the doomsday predictions. No such respectable targets achieved except inflation as per the economic survey 1998-99 (Government of Pakistan - Economic Survey 1998-99). The signs of recovery are still far away. For last two years tax breaks stimulus of supply side medicine failed to jump start the economy, as the large scale manufacturing and private investment failed to pick up economy substantially. The second prescription of demand stimulus through expansionary fiscal policy or under the umbrella of easy monetary policy of rescheduling of debt, low interest rate and low inflation worked less. The question is: Will these policy combinations take off the economy out of deep recessionary conditions or revive the economy and restore the business confidence? When all the targets of macro economic indicators such as growth of GDP, manufacturing, agriculture, export, saving and investment show a depressed picture (Government of Pakistan - Economic Survey 1998-99) See Table 2.

**TABLE - 2**  
**SELECTED MACRO ECONOMIC INDICATORS**

Description	1996-97 R	1997-98 R	1998-99 (Targets)
Real GDP at constant factor cost	1.3	5.4	6.0
Agriculture	0.1	5.9	5.4
Major crops	-4.8	8.4	5.5
Minor Crops	1.1	3.3	5.0
Manufacturing	1.2	7.0	7.2
Large Scale	-2.3	6.2	6.5
Small Scale	8.4	8.4	8.4
Services Sector	2.1	4.8	5.7
Consumer Price Index (1990-91 = 100)	11.8	7.8	8.0
Domestic Liquidity	12.2	14.2	7.8
Domestic Credit	15.3	15.0	6.5
Exports (f.o.b)	-2.6	4.2 R	-1.6 <sup>1</sup>
Imports (f.o.b)	-6.4	-8.4	-18.3 <sup>1</sup>
Liquid Foreign Exchange Reserves (Million US dollar)	1219.0	930.0	1876.2 <sup>1</sup>
<b>As Percent of GDP</b>			
Total Investment	17.4	17.3	18.7
National Saving	11.2	14.5	17.2
Tax Revenue	13.0	13.1	13.5
Total Revenue	15.4	15.8	15.9
Budgetary Expenditure	21.6	21.3	20.2
Budgetary Deficit	6.3	5.5	4.3
Current Account Deficit (Excluding Official Transfers)	-6.2	-3.0 R	-3.0 <sup>3</sup>
Domestic Debt	43.3	41.7	-
Foreign Debt	46.9	49.5	-
<b>Total Debt</b>	<b>90.2</b>	<b>91.2</b>	<b>-</b>

Source: The State of Pakistan Economy: Second Report for the year 1998-99 submitted to the Parliament.

<sup>3</sup>. Based on IMF Projections for 1998-99 R; Revised Estimates P: provisional.

In the Economic Survey of 1998-99 budget deficit was shown 4.3 percent of GDP. As a matter of one day on June 12, 1999, astonishingly the fiscal deficit was announced 3.4 percent of GDP means Rs.101.40 billion compared to Rs.136 billion as per the agreement with IMF. Even Rs.136 billion is subjected to CBR revised estimates of Rs.328 billion Tax Revenue collection. The revised estimates again lowered to Rs.308 billion. In a matter of one day Government reduced 35 billion of deficit and saved Rs.55 billion. This is called "Darnomics". The name given to the practice of using pure magic in macroeconomics. The too ambitious target of Rs.365 billion tax resources is unrealistic and unachievable. Where-as the current year's (1998-99) 11 months collection is Rs.259 billion and the end of the fiscal year will not cross the Rs.300 billion. For the next year Sales tax projection is estimated Rs.96 billion with an increase of 34 percent from 74 billion collection of this year. This source of revenue continues to remain largely uncertain because lot of loopholes existed in the system of imposition and collection. The projected increase of Rs.5 billion in custom duties from Rs.61.30 billion to Rs.65.50 billion seems to be too unrealistic as the trend in world economy is showing recessionary in nature: the unit prices of imports are likely to remain largely depressed. Same is supposed to be observed in collection of Federal Excise duty as the projection is higher level from 62 billion this year to 67 billion next year.

The significant squeeze is observable in income from surcharges plus expected below target collection from tax revenue specially from sales tax would enlarge the gap between income and expenditure of atleast Rs.60 billion. By adding 67 billion from debt servicing relief and subtracting 13 billion as negative bank borrowing the total

income this year becomes 588 billion. If the expected shortfall of Rs.60 billion the total income becomes as low as Rs.528 billion. This would result expansion of Gap to Rs.114 billion. Seemingly, the budget does not provide the servicing of commercial debt amounting to about one billion dollar, which had been obtained for short period at very harsh terms. The burden of such servicing would certainly be Rs.15 billion. As the government is expecting rescheduling on the same pattern as provided by the Paris club. It is observable that negotiations take time as usual, then, there is only one option available either to pay the commercial debt or to be declared as defaulter. If we count the servicing of commercial debt of Rs.15 billion, the gap is likely to go much beyond the Rs.130 billion. If we add Rs.60 billion of non bank borrowing projected in the budget, the budget deficit would be expected to an all times high of Rs.190 billion and if the GDP trend is expected to be lower than 5 percent, which is surely expected, then, the Budget deficit is expected to be not less than the 7 percent of GDP. The experience of a large number of developing countries clearly shows that unsustainable fiscal deficits push an economy into a trap wherein an upward spiraling cycle of inflation - devaluation rising interest rates - rising wages and salaries - rising inflation could disrupt production and lead to large scale unemployment and capital flight with de-stabilizing socio-political consequences.

There is clear tilt in revenue collection, as this year's figures are showing that revenue largely depends upon the non-tax revenue and less on tax revenue collection, for example this year trend is higher collection of surcharges, non bank borrowing, and external resources: these resources have tended to constant increasing trend. This is definitely the opposite trend of IMF's prescription.

Tough application of an adjustment program.<sup>2</sup> Where-as to meet the IMF's conditionalities of reducing the budget deficit upto 3.3 percent of GDP, the people would have to take tough injection of Rs.65 billion more of additional taxation. Suppose, if the government is not meeting the targets which surely is not feasible in current economic scenario, then, government will have to resort on printing money or resume as usual on bank and non-bank borrowing, then, the advantage of lower interest rate will be weakened.

The serious problem Pakistan is confronted with today is the perceived insolvency in the external account, with its rising external debt, tumbling exports and worsening current account balance, which seriously jeopardized its sustainability and sovereignty. According to Finance Minister's own article external debt is expected to rise at 4.3 billion dollars at the end of June 2000, which is based on optimistic forecast of exports, current account deficit and remittances. According to independent economists sources, it would increase much higher. The total debt at the end of the program is expected to be 38 billion dollars with 6 billion dollars average annual service cost. Even Pakistan is unable to service the current level of 32 billion dollars debt. Notwithstanding the magical techniques of "Darnomics". Our inability to honor

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2. Commonly includes a combination of (1) fiscal and monetary policies to bring about over-all demand reduction (2) trade policies (mainly exchange rate and import/export taxes and subsidies) to alter the relative incentives between tradable and on-tradable goods. On the micro side, the major objective is to improve efficiency in the use of resources by removing the price distortion, opening up more competition and dismantling administrative controls (de-regulation). Such programs include lowering of government expenditure as well as reduction of the governments presence in areas where private enterprise can operate more efficiently.

an external debt liability is the reflection of the "Debt Trap". According to Finance Minister's speech (Dawn 13, 1999) that Rs.62 billion domestic debt has been retired. Prior to this government was pleased about its success in getting the external debt rescheduled. In 1998-99 over Rs.90 billion in external debt has been rescheduled. According to SBP 1997-98 (See Table 3) outstanding public debt is Rs.2518 billion equivalent to 91 percent of GDP. Out of which 1367 billion or 51 percent is external in nature. Servicing Rs.278 billion which accounts for about 55 percent of recurring expenditure and pre-emp about 62 percent of total revenue. External debt to GDP ratio for 1999-2000 is projected to be 58 percent implying a further increase of four percentage point of GDP next year.

TABLE - 3  
PUBLIC DEBT -TO -GDP RATIO

Years	Total Debt	Domestic Debt	Percentage Point External Debt
1993-94	92.2	44.6	47.6
1994-95	84.1	42.4	41.7
1995-96	85.9	42.0	43.9
1996-97	89.2	43.3	45.9
1997-98	88.4	42.3	46.1
1998-99	93.8	40.5	53.3

Source: State Bank of Pakistan, Annual Report, 1997-98, Pakistan Economic Survey, 1998-99

Accumulation of external debt implies higher dependence on foreign financial institution and thereby goes contrary to the whole theme of greater "Self-Reliance". Secondly, unlike the domestic debt, external debt has to be paid in foreign exchange, increasing the balance of payments vulnerability of the country.

Instability in exchange rate can substantially lose the capital. We are entering into the 21st century with the promise to donors that our coming generation will repay all the liabilities. When the time comes in June 2001 our rulers will again negotiate the rescheduling with tougher and unreasonable terms. In order to increase debt servicing capacity, the economy needs drastic operation of structural adjustment, arresting of loan defaulters, broaden the tax base, drastic reduction in defence expenditure, forceful implementation of land reforms, confiscation of assets of illegal accumulation of wealth of lords and generals, improvement in criminally neglected social sector. But this requires the will, the courage and the commitment. Unfortunately, in our government this is in short supply. If the governments which cannot impose the taxes on the rich cannot protect the poor. Scraping Zila tax, raising the wealth tax thrash hold to 2 lacs (from present one lac), lowering excise duty on phone bills, abolition of radio license fee, and above all much needed raise in salaries of government servants steps of nominally commendable, as no significant provision provided for the rehabilitation of the worst affected cyclone hit areas, poverty stricken, unemployed floods, women and children, education and health. The abolition of Zila tax and Octroi would have positive and far-reaching effect on informal economy as the cost of production would go down, significant relief is expected to retail trade, small entrepreneurs. The housing and transportation measures are just formalizing the informal economy. The question is whether this normalization of transportation, construction, small enterprise, retail trade of the economy/or informal sector will revive the economy? The 20-25 percent increases in the basic pay of government employees and the retired personnel would benefit marginally 3.5 million people, but, substantially treated less than par with increase in salary of military employees.

Universal Self-assessment scheme, construction of 5,00,000 low-cost housing (an allocation of Rs.50 billion) will benefit marginally if the poverty and unemployment level remains the same.

### CONCLUSION

Most of the measures in current budget imply a tilt towards re-invigorating and strengthening the "formal"/informal sector e.g. transport, construction, small enterprises and retail trade, of the economy. Will the sector be an engine for revival of the formal economy and restore the business confidence? The question and the answer depend on the strength of inter-dependencies and inter-temporal linkages between formal and informal sectors of the economy.

The problems of Pakistan require for their solution immediately is, overhauling of its monetary, financial, industrial, agricultural and commercial policies - a task decidedly beyond the capabilities of the governments of Muslim League and the PPP.

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