ISAS Brief

No. 245 – 12 June 2012

469A Bukit Timah Road
#07-01, Tower Block, Singapore 259770
Tel: 6516 6179 / 6516 4239
Fax: 6776 7505 / 6314 5447
Email: isassec@nus.edu.sg
Website: www.isas.nus.edu.sg

Pakistan's 2012-13Budget: A political rather than an economic document

Shahid Javed Burki[1]

Abstract

Pakistan People's Party (PPP), the leading political group in the coalition that has governed from Islamabad since 2008, presented the budget for the financial year 2012-13. It took great pride in the fact that this was the first elected government in Pakistan's history that was presenting a budget for the fifth consecutive year. This was considered to be a triumph for democracy. But this sense of triumph was tarnished by the way the budget speech was received. It was read out by Finance Minister Abdul Hafiz Sheikh on Friday 31 May 2012. The presentation was made before a raucous parliament, with the main opposition party, Pakistan Muslim League (Nawaz), protesting the presence in the chamber of Prime Minister Yusuf Raza Gilani who had earlier been convicted by the Supreme Court for contempt. It was expected that this conviction would lead to the prime minister's resignation. That did not happen and the opposition, led by Imran Khan, president of the Pakistan Tehrik-e-Insaf, had moved the court to remove Mr. Gilani from his position. This paper suggests that the 2012-13 Budget is more of a political than an economic and financial document. It postpones addressing the difficult problems the country currently faces, expecting that the PPP will have another term after the next elections that must be held before the end of the spring of 2013. Then it could deal with the economy.

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[1] Shahid Javed Burki is Visiting Senior Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore. He was former Finance Minister of Pakistan, and former Vice-President of the World Bank. He can be contacted at sjburki@yahoo.com. The views expressed are those of the author and do not necessarily reflect the views of the institute.

A few days before his administration was to present its budget proposals, Pakistan's Prime Minister Yusuf Raza Gilani informed the country of his main economic priorities. These had nothing to do with steadying a troubled economy and everything to do with trying to win the next election. In a democratic system it is legitimate for the governing party to showcase public sector expenditures for winning elections. This happens in both developed and developing countries. But while helping political supporters and those sitting on the fence is acceptable, what is not right is to use the public purse to create massive economic problems. That is precisely what is likely to happen if the proposals made in the 2012-13 Budget are fully implemented.

The most worrying aspect of the budget is on the expenditure side. In his speech the Finance Minister expressed some frustration that he had not succeeded, in spite of the promise made by him, to lower the fiscal deficit to 4.1 per cent. It came out instead at 7.6 per cent. This was because of slippages in both expenditures and revenue collection. The government had spent much more and raised far less than promised by way of taxes. Its subsidies had also increased in particular in the power sector. The failure to meet last year's targets was attributed to the government's inability to stick to the timetable for licensing the 3G telecommunication bands. These were expected to yield handsome financial rewards. Also, Islamabad received considerably less from the United States- managed Coalition Support Fund by way of compensation for the support Islamabad provided to Washington and its NATO (North Atlantic Treaty Organisation) allies in the 'anti-terror' war in Afghanistan.

The Finance Minister has now said that the government will attempt to reduce the amount of subsidies in particular those given to WAPDA (Water & Power Development Authority). In light of the on-going implementation of the 18th Amendment to the Constitution that transferred a number of functions from the federal government to the provinces, the Ministry of Finance expected to transfer much smaller amounts by way of grants and loans to the provincial governments. The promise for austerity was balanced by some indication of generosity. Government employees were to receive an increase of 20 per cent in their salaries and pensions.

The Prime Minister has said that his first priority is not to impose any new taxes. He didn't say whether the administration would reform the tax collection system in order to bring in those who have managed to escape the tax net and thus forced the tax-to-GDP (Gross Domestic Product) ratio down to less than nine per cent, one of the lowest in the world. The budget tinkered with the tax system but did not make any significant structural changes. This is in line with the Prime Minister's pre-budget pronouncements which appeared to indicate that the ruling party had no interest in improving the country's deteriorating fiscal situation. According to the Finance Minister's estimate, his proposed measures will now increase the tax-to-GDP ratio to 10.1 per cent. This is only a marginal improvement and will not leave the government's financial position much healthier, than it is today, when the present administration completes its current tenure.

How will the economy revive if the fiscal deficit remains large – at an unsustainable level – is a question that was left unanswered in this budget. It was not recognized that the government's neglect of the social sectors is a consequence of its strained fiscal circumstances. Without increasing the outlays on education and health as well as on training the rapidly growing work force, the country is setting the stage for rates of growth that will remain anaemic for years to come.

While much of the responsibility for the social sectors is now with the provinces, the provinces can only fulfil their mandate if they have the resources to do so. This should be the first priority of the government in the post 18th Amendment period, not a strong pledge that the tax burden will not be raised. We know from the experiences of other democratic systems that no-new-taxes types of commitments can tie down democratic states in difficult fiscal postures.

The government's second priority is to improve the energy situation which is now not only costing the economy dearly but is resulting in enormous discomfort for the population. Those who have attempted to estimate the damage to the economy have come to the conclusion that it is even more problematic than the rise of terrorist activities in the country. The government has had four years to deal with the situation but it has only worsened. There was mishandling of some of the measures that were adopted in particular for increasing generation capacity. First the Asian Development Bank in its review of the steps taken to buy power from rental units and later the Supreme Court came to the conclusion that there was considerable misuse of public money associated with this programme.

There is also agreement among the experts in the energy area that the sector in Pakistan is poorly managed. Generation capacity, it is said, is not the real problem; managing the sector is the most important issue. However, very little attention has been paid by the authorities to formulate a comprehensive strategy to deal with the worsening situation. The budget mostly ignored the subject.

It is the Prime Minister's third priority that must cause a great deal of concern to those who worry about the country's deteriorating economy. Mr Gilani said – and the budget reiterated – that his administration will create 100,000 jobs in order to provide relief to the unemployed. Pakistan has paid little attention to improve the economy's statistical base in general. Data concerning the labour force are exceptionally weak. A simple back-of-the envelope exercise suggests that some five to six million people must be looking for work. Creating 100,000 jobs, therefore, touches only a small part of the problem equivalent to about 0.5 per cent of the unemployed. The government's focus in an election year, therefore, will be on creating jobs in the public sector, in particular in the already-stressed government-owned enterprises. Entities such as the Karachi Steel Mills, Pakistan International Airlines, the WAPDA and the Railways are already groaning under the weight of employment that serves the interests of the politicians who have the power to impose additional employees on these organizations. This way of managing public sector enterprises sets up a chain reaction that does not seem to concern today's policymakers.

Loss-making enterprises in the public sector are ultimately helped by the government although their deficits don't figure in the official numbers about government finance. Not able to raise resources through taxation, the government resorts to printing money. The amount printed will no doubt increase as election-related expenditures rise during the year. As every student of economics knows if the amount of money chasing a limited amount of goods increases, it causes inflation. Pakistan has had double-digit inflation now for several years. Its incidence will increase as the Prime Minister and his team follow the announced policies. The real danger about persistent increases in prices – in particular the prices of goods of everyday use – is that it generates inflationary expectations. These bring about a fundamental change in economic behaviour which is highly damaging for the long-term performance of the economy. We know from the experience of Latin America, which lost a decade worth of development because of spiralling price increases, that to reverse inflationary trends takes tough measures. Few governments have the political will and the strength to implement such a policy package.

The PPP-led government believes that it may have found a way of softening the impact of its "print, print, print" money approach to economic management. Some of the printed money as well as some of the assistance received from international development agencies are going into the Benazir Income Support Fund. The BISF is reasonably well managed and it appears that because of the safeguards, which have been built into it for identifying the families that receive regular grants to supplement incomes, funds do reach the intended beneficiaries. In other words the programme is protected from the types of leakages that are common with such income support programmes. That said, the problem is with the macro aspects of the programme – the source of its funding. The cash-strapped government – and the one in the words of the Prime Minister committed to not increasing taxes – will once again resort to printing money. This will add to inflationary pressures.

There is circularity about this approach for helping the poor. A thousand rupee income-supplements a month for the target households – these are the amounts targeted by the BISF – will certainly provide relief to these families. However, inflation that will result from raising the needed resources by printing new money will quickly erode into the buying power of the beneficiaries. As inflation eats into the relief they receive the beneficiaries will demand an increase in the amounts they receive. A government that has built its political support on a programme such as BISF will find it difficult to resist this pressure. The size of the programme will continue to increase, the amount of money needed to fund it will continue to be provided by the printing press, the rate of price increase will continue, and the government will continue to move in this vicious circle. It is not clear whether the Prime Minister's economic advisors have briefed him on the dangers that lurk in his three-point programme. Not being mindful of these pitfalls means condemning the economy to perform poorly.

The latest budget has not dealt with any of the serious issues faced by the country's economy. Its proposals will neither quicken the rate of economic growth; nor reduce the financial dependence of the government on the printing machine operated by the State Bank; nor indeed make the country less dependent on official capital flows in order to pay for the large and growing trade deficit. This budget will also not improve the performance of the state enterprises that are a heavy drain on the budget; not improve fiscal relations between the central government and the provinces; not reduce the rising level of inflation; and will not provide jobs to the unemployed in order to reduce the high incidence of poverty. The government seems interested in getting another term and expects that it can address these problems once it is back in office. However, by then the situation would have worsened considerably.

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