Research Report No. 35

EVALUATION OF THE FEDERAL BUDGET, 2000-2001

SOCIAL POLICY AND DEVELOPMENT CENTRE

RESEARCH REPORT

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JUNE 2000

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SOCIAL POLICY AND DEVELOPMENT CENTRE

FOREWORD

The Social Policy and Development Centre (SPDC) has a tradition of bringing out a Research Report every year containing analysis of the proposals for expenditure and taxation in the Federal Budget from the viewpoint of their impact on the economy and people of Pakistan. This year's report contains 24 articles on various aspects of the Budget of 2000-01, written by staff members of SPDC. We hope that government officials, private sector, members of NGOs and civil society at large will find this report useful in understanding the implications of the Budget.

Dr. Hafiz A. Pasha
Managing Director

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BUDGET 2000-01: REVIVAL STRATEGY REVISITED

By
Dr. Sajjad Akhtar

The budget 2000-01 signals a second attempt by the economic managers at engineering an upturn in the economy. The attempt at economic revival by the deposed Nawaz Sharif government after the imposition of sanctions and a new program with the IMF was prematurely replaced by a modified revival plan of the new apolitical government in December 1999 announced by the Chief Executive. The budget 2000-01 merely reinforces and formalizes the December 1999 program with minor changes. It is heartening to note that in certain respects the current economic managers are less presumptuous than their previous political counterparts. They regard the improvement in growth rate from 3.1 to 4.5 percent as ‘‘stabilization’ rather than revival or recovery. Moreover good weather is recognized as major contributor to above target performance of agriculture this year. Its growth is recorded as 5.5 percent (which in the final count may climb to 7.1 percent if the estimates of wheat crop are closer to 21 million tons) against the target of 4.3 percent and actual growth of 1.9 percent last year. Interestingly announcing a more realistic target of 11.3 percent for exports goes to the credit of this regime against the permanent fixation of 18 percent growth of the economic managers of the previous regime (however the trade policy has raised this target to 15 per cent).

This exogenous improvement in the real economy or ‘manna from heaven’ also raises a more fundamental question, i.e., what constitutes a revival? Is it in tandem or balanced growth of three major sectors i.e., agriculture, manufacturing and services or exceptional performance of any individual sector raising the overall growth of the economy can be termed as revival. Can the fragile and unsustainable nature of monetary indicators such as current account and/or budget deficit be traded off with growth of real sectors to label an economy on upswing. Many regard a low inflation rate for a developing economy like ours as a sign of deep recession. Given that for greater part of Pakistan’s economic history, stabilization indicators have been fragile and only during the last few years have become unsustainable while growth has been respectable (except that average growth has fallen in the last decade), we will continue to regard balanced growth as the main indicator of revival. Under this criteria, the current year growth of only 1.6 percent in the manufacturing (6.4 percent excluding sugar) prevents the analyst (in spite of

impressive growth in the agriculture sector) to unequivocally claim that the economy is well on the path of recovery.

Let us briefly dilate on why a broad based economic revival failed to take place. Was it a failure of policy package which ex-ante consisted of a fiscal stimulus and easy monetary policy? Can political distortions and uncertainties during the year be blamed for lack of investor's confidence? May be mini-shock therapies in the form of recovery of defaulted loans, anti-smuggling drive and documentation of the economy exerted negative impact on economic activity. From an economic policy perspective the planned fiscal stimulus failed to materialize. The budgeted Rs.116 billion for PSDP was scaled down mid-year and estimates of actual expenditure are Rs.100 billion for the year 1999-2000. So much for the fiscal stimulus needed for revival. The use of easy monetary policy for economic revival failed miserably. Downward adjustment in lending rates did not generate demand for private credit. As a result private sector lending was 1/3rd of the targeted amount. Overall the money supply (M2) expanded by 3.2 percent in the 9 month period against the target of 8.8 percent for the whole year. Implicitly the economy failed to realize the gains of debt re-scheduling routed through easy monetary policy. Unfortunately the effectiveness or impact of monetary policy relies more heavily on the private sector behavior than does fiscal policy. One can safely assert that non-economic factors played a major role in depressing the private sector response than any fundamental weakness in the policy package itself. Exchange rate policy as a tool for economic revival remained dormant last year as 'peggers' were firmly entrenched in the decision making process.

Is the policy mix announced in the current budget for economic revival radically different from the one announced last year? Even a cursory look will reveal that it is not. It is again a combination of higher development expenditure with easy monetary policy. However as per statement of the finance minister, exchange rate policy may now be allowed to play a more active role than in the recent past. We hope this ideological tilt is the recognition of efficacy of 'export led growth' rather than pressure from the multilateral donor agencies or a short term action in deflecting the impending balance of payments crisis.

As in the last year, fiscal stimulus largely hinges on the success of resource generation and curtailment of non-development expenditure. Otherwise it may be scuttled by mid-year. Compared to the Public Works program planned last year, the fiscal stimulus is to be routed through Integrated Small Public Works Program (ISPWP). Given the non-political setup and monitoring by defense personnel, this initiative at the local level may generate larger official multiplier effect at the cost of lowering 'kickback' multiplier. However corresponding private motivation and capacity to secure small contracts may be much weaker. Theoretically as a component of easy monetary policy, lowering the NSS rates by another 1.5 percentage points should translate into lower deposit and lending rates and thereby boost private credit demand. But the non-economic factors which sabotaged the easy monetary policy in the current year are likely to be ever present in 2000-01.

Stable political and sustainable macro environment are key inputs into investor's confidence and expectation level. Interest costs on borrowed funds are only a small element in any decision to invest. After law and order (and of course the writ of the government) conditions the second major element in restoring investor's confidence is profitability. In the past profitability in the economy was being maintained artificially by a distorted trade regime, undocumented tax regime, porous banking sector and political rent-seeking. Since the change of government signals have been sent out that this will no longer be the case. Thus the only possibility to extract above normal profits from traditional productive activities is to reduce costs per unit through efficiencies, new technologies and scale economies. Major alignment of rupee vis-a-vis dollar will implicitly reduce labor costs relative to capital and thus increase the profitability of the existing archaic manufacturing sector plus non-traditional export sector and at least help to revive the manufacturing sector including the small-scale.

Let us evaluate the prospects for agriculture. Realizing the historical empirical rarity that a high growth of 5.5 percent or for that matter 7.1 percent in agriculture has not been possible in two consecutive years, the next year growth has been scaled to 3.9 percent nearly 30 percent below the current year level. Apparently the effect of prolonged drought conditions on agriculture have been factored in. Most of the measures introduced in the budget are aimed at medium term revival rather than short-term revival. Achieving autarky in edible oil through increased

production of edible oil seed is structural and institutional in nature. Similarly corporatizing agriculture sector is not a overnight phenomenon. Centuries old land ownership and tenure systems along with benami holdings, clan rivalries, water rights and poor documentation will be formidable hindrance for small land holders to join together for reaping the scale benefits of corporate agriculture. Will big landlords be motivated to bring the large land holdings under commercial cultivation?. This is possible as long as the benefits of access to unlimited banking credit are offset by costs of coming under taxation net. Chances are that if transnational food companies decide to go into corporate farming in Pakistan, big landlords will find at least a doubling of their land values overnight. Improving the price regulatory role of TCP is again an administrative measure rather than a direct price incentive. To the extent that middlemen and exporters pass on the benefits of unregulated exports of agriculture produce to farmers it is a supply incentive for the farmers. However the volatility in international prices and appropriation of profits by the exporters/middleman due to information lag and quality differentials do not create significant supply incentives for the farmers.

The current year's performance of manufacturing sector once again establishes the strong backward linkage of industrial sector with agriculture. With a slump in sugar-cane production and thereby in 24 percent fall in sugar production, large-scale manufacturing sector recorded almost a zero (0.04) growth rate. Without sugar production its growth was 6.4 percent above the targeted 4.3 percent for the entire large-scale manufacturing. Readers should recall that a converse story had developed in 1997-98. Because of exceptional output of sugar cane in that year, the large-scale manufacturing (LSM) grew at 7 percent. Excluding it the growth was only 1.6 percent.

Thus after fifty years the economy can be now up-graded from a single-crop (i.e., cotton) to two crop (cotton and sugar-cane) economy! So much so for industrial diversification! Does the apparent revival of manufacturing at 5.9 percent in 2000-01 implicitly assume a bumper sugar-cane production? A backward causation would then imply that the policy makers expect a substantial increase in sugar-cane output to more than offset declining or stagnant output of cotton and wheat next year to achieve a 3.9 percent growth in agriculture. A look at the annual plan 2000-01 assumes a 11.5 percent increase in sugar-cane production from a decline of 16

percent this year. Interestingly it assumes a decline of 4.8 percent in cotton production and an increase of 6.3 percent in wheat if the current year production of 19.3 million tons is assumed. If the realized production for this year is 21 million tons, next year target is 20.5 million tons. Revitalization of Small Business Finance Corporation and SMEDA are institutional measures rather than signals for increasing profitability of small-scale manufacturing. Unless there are price signals which improve the profitability of labor intensive export sector or quick rents to be made through 'business friendly' policies rather than 'market friendly' policies along with effective law and order, pick-up in investment will remain a question mark.

The third plank of revival strategy is the hope that private sector will zoom the economy through information technology super highway. There is a wide spread feeling among the analysts that with China and India riding the IT wave we have already lost our place on the lower end of IT bandwagon. Within the IT sector precise niches have to be identified and then developed by the private sector. Human capital in the form of education, training and experience is the most crucial ingredient in its development. IT labor market changes rapidly and is far too complex and globalized to expect that we right now have the requisite manpower to get on to the super highway in a matter of a year. Human capital in this sector be created where the economic and social return is the highest. Lowering costs in IT business will only help marginally.

In short, at the macro policy level there are no bold initiatives or 'big push' towards short-term revival either from the demand or the supply side and the incremental or marginal approach adopted in the current budget is a reflection of the constraints faced by the economic managers in the last few years.

WHITHER MACROECONOMIC FRAMEWORK?

By
Dr. Sajjad Akhtar

The credit for announcing the briefest three year macro economic framework in the history of Pakistan goes to the current team of economic managers. It consisted of six economic targets for the year 2002-2003 along with eight rhetorical policy instruments to achieve those targets, all fitting conveniently into one typed written page. The serious analyst is left bemused on how to evaluate and analyze a medium term economic road map for revival when it is scanty, left mostly to imagination and apparently consists of interpolation or average between two points in time i.e., 2000 and 2003. However accepting less than transparent nature of the macro economic framework as genuine planning constraints faced by the present policy makers, we go ahead and analyze the internal consistency of the framework and underlying assumptions about the performance of some of the major macro economic indicators driving the framework. The new targets (referred to as MEF targets) announced in the budget will be compared to those set by the Macroeconomic Framework Sub-group of Economic Advisory Board (referred to as sub-group estimates henceforth) in the earlier this calender year.

For the economic analyst the single most eye catching target in the macro economic framework is the overall growth rate of the economy predicted for the year 2002-03. A 6 per cent target signifies at least a return to economic performance of the eighties and early nineties and a halt to increasing poverty. Is that achievable? Even under a optimistic scenario the sub-group estimates were 5.3 per cent for the terminal year. In slightly technical jargon an incremental capital output ratio of 2.75 is being assumed by the planners against the historical three. It is a highly sticky and structural measure of productivity of capital and is unlikely to change dramatically from a current level of 3.2 to 2.75 in a matter of 3 years. What remains the basis of this perceived improvement by the planners in the face of archaic manufacturing sector remains unclear. Moreover it seems that the MEF growth target is the basic number for top-down derivation of other macro indicators.

Investment in any developing economy is financed by national and foreign savings. Planners hope that current account deficit, a measure of foreign savings will come down from 2.8 per cent of GDP in 199-2000 to 0.5 per cent (more will be said about the feasibility of this target later) by fiscal year 2003. Substracting foreign savings of 0.5 per cent of GDP from the targeted Investment/GDP ratio of 18 per cent gives us the national savings rate of 17.5 per cent of GDP required to achieve the investment and growth target. In other words the saving/GDP ratio would have to rise by 5.2 (from the current 12.2 per cent) percentage points in a matter of 3 years!! A simple calculation reveals that this implies a marginal saving rate of 48 per cent, i.e., 48 per cent of additional income generated by the end of the third year will either be saved or taxed away by the government sector and add to public savings. Such a marginal saving rate has never been attained by the economy in the past. Using a bottoms-up approach the sub-group estimated that national saving could only rise to maximum of 16 per cent of the GDP in the terminal year i.e., 2002-03. Even the sub-group estimates assume a herculean effort at broad basing of tax regime, removing exemptions and reducing tax evasions. Interestingly the macroeconomic framework is silent on the break-up of national savings into public and private saving and further break-up of public saving into government and other public entities. It also needs to be recognized that the macroeconomic strategy envisages a substantial increase in tax-to-GDP ratio. To the extent that the additional tax revenues cut into private savings it will be difficult to achieve simultaneously fast savings by households. An environment of declining returns on national saving instruments and deposit rates will also lead to downward movement along the supply curve of savings in the economy.

What are the implied annual rates of growth of exports and imports that will lead to a current account deficit of 0.5 per cent of GDP in the terminal year 2002-2003 ? While the macro economic framework is silent on these sub-components, it is estimated that exports would have to grow at an annual rate of 14 per cent and imports at 3 per cent in dollar terms. Interestingly the first year of the strategy starts off with pitching growth rate of exports of 15 per cent to achieve target of $ 10 billion next year. Incidently the MEF sub-group current account deficit estimates are based on an export growth rate of 10 per cent. In the absence of any import compression or a fast track import substitution strategy, holding down the growth of imports at 3 per cent in the face of an 18 investment growth target is almost an impossibility. Moreover,

this strategy of increasing exports envisages an annual depreciation of the rupee by 10 per cent, i.e., on average a 5 per cent real devaluation of the currency every year. The target of holding down average inflation at 4 per cent for the period with active exchange rate policy will almost be a miracle! Does embarking recently on a regime of crawling exchange rate adjustment signal that policy makers at last realize that ex-ante the trade gap will be the binding constraint in the short to medium term?

The above analysis clearly indicates that the MEF target of 6 per cent growth rate in 2002-03 crucially hinges on closing the two gaps, i.e., investment-saving and trade gap. We have highlighted the tenuous nature of assumptions on which such a closure is based. Two key conclusions emerge from the proposed three year macroeconomic framework. First, given the low level of national savings in Pakistan and given the need to restrict the current account deficit, following the end of the period of debt relief in December 2000, it is unlikely that the economy can attain a relatively high growth rate once again of 6 per cent or more in the forseeable future. Second, policy makers will have to focus on different policy instruments depending upon which gap appears larger ex-ante. If the investment-savings gap appears to be larger than the trade gap then interest rates will have to be focused on and a policy of raising interest rates followed. Alternatively, if the trade gap is larger then a depreciation in the exchange rate may need to be considered along with tighter aggregate demand management. All in all, like the budget, the three year macroeconomic framework appears to be more of an exercise in wishful thinking.

FEASIBILITY OF MACROECONOMIC TARGETS FOR 2000-01

By
Nadeem Ahmed
Aisha Bano

After years of low to medium growth, the basic question is whether in the coming year Pakistan's economy will begin to get back to a relatively high growth path. Short run prospects for the world economy look encouraging and most of the South East Asian and East Asian economies which had experienced a severe financial crisis in 1997-98 have already emerged from a deep recession and begun to show high growth rates once again. Most South Asian economies are showing growth rates in excess of 5 per cent. Will Pakistan's economy, which suffered a severe negative shock following the nuclear blasts and imposition of sanctions in 1998 also show the same kind of recovery in 2000-01? The objective of this article is to analyse the macroeconomic prospects for the next year.

Growth

Targets for GDP growth, investment and savings, external sector and the monetary sector are set by the National Economic Council (NEC), headed by the Chief Executive, in the Annual Plan for the coming year. For 2000-01, the GDP growth target has been fixed at 5 per cent, a modest increase over the growth rate achieved this year

TABLE 1
TREND IN MACRO-ECONOMIC INDICATORS AND TARGETS FOR 2000-2001

	Unit	AVERAGE		Actual	Annual
		1999-91 to 1994-95	1995-96 to 1999-2000	1999-2000	Plan 2000-01
A. GDP Growth	%	5.06	4.12	4.46	5.00
● Agriculture	%	4.19	4.63	5.54	3.90
● Manufacturing	%	5.75	3.94	1.57	5.90
● Services	%	5.12	4.08	4.48	5.20
B. Investment	% of GDP				
● Total Investment	"	19.51	16.73	15.01	15.66
● Fixed Investment	"	17.97	14.93	13.38	14.05
● Public	"	8.56	6.09	5.33	5.57
● PSDP	"	5.70	3.68	3.20	3.46
● Private	"	9.31	8.83	8.05	8.49
C. External Sector					
● Trade Balance	Million $	-2504	-2532	-1862	-1304
● Growth in $ Export	%	10.90	1.43	10.70	11.10*
● Growth in $ Import	%	9.25	-0.26	6.10	3.60
● Current Account Balance	Million $	-2330	-2883	-1695	-1260
● Current Account Balance	% of GDP	4.50	4.65	2.80	1.90
D. Monetary Sector					
● Rate of Inflation (CPI)	%	11.47	7.91	3.40	4.50
● Growth in Money Supply	%	19.34	10.32	4.90	9.00

**This has been changed to 15 per cent in the trade policy*
Source: Pakistan Economic Survey 1999-2000
Annual Plan 2000-2001

of about 4½ per cent (see Table 1). After a year of exceptional growth agricultural production is expected to stabilise and show a more modest growth of 3.9 per cent next year. The manufacturing sector which had shown slow growth, with the large-scale component remaining static, in 1999-2000 is expected to stage a strong recovery with the growth rate approaching 6 per cent.

The likelihood of 5 per cent growth in 2000-01 rests, therefore, on two crucial assumptions, first, that high levels of output of major crops like cotton, rice and wheat attained this year will be largely sustained and even surpassed in some cases like wheat and, second, that the large-scale manufacturing sector will recover largely on the back of continuing buoyancy in the textile sector. Also, next year could well be the sugar year once again as in 1997-98 with almost 14 per cent growth expected in output (see Table 3) achieved by a large increase in sugarcane production of almost 12 per cent (see Table 2).

TABLE 2
OUTPUT OF MAJOR CROPS

	Unit	1998-99	1999-2000	2000-2001	Growth Rate 1999-2000 (%)	Growth Target 2000-01 (%)
Rice	(000 MT)	4673	5155	5155	10.31	0.00
Sugarcane	(000 MT)	55191	46333	51663	-16.05	11.50
Cotton	(Mln Bales)	8	11	10	27.27	-4.46
Wheat	(000 MT)	17857	19288	20500	8.01	6.28

Source: Annual Plan 2000-2001.

TABLE 3
OUTPUT OF MAJOR INDUSTRIES

	Unit	1998-99	1999-2000	2000-2001	Growth Rate 1999-2000 (%)	Growth Target 2000-01 (%)
Sugar	(000 MT)	3541	2412	2745	-31.90	13.81
Cement	(000 MT)	9599	9721	10168	1.27	4.60
Paper & Board	(000 MT)	356	406	446	14.07	10.02
Fertilizer	(000 MT)	1773	1894	2017	6.81	6.50
Billets	(000 MT)	276	328	387	18.83	17.98
Cotton Yarn	(000 MT)	1540	1683	1885	9.28	12.00
Cotton Cloth	(Mln Sq. M)	384	442	507	15.11	14.68

Source: Annual Plan 2000-2001.

A number of risk factors can be identified at this stage. First, there are the vagaries of the cotton crop, which have led to large fluctuations in output in previous years. The farmers had a bad experience last

year when the bumper crop led to a precipitous fall in prices received by them and it is unlikely that they would want to devote the same resources to this crop again so soon. On top of this, the water shortage will clearly have negative implications on the area sown. Therefore, if cotton output falls by more than the anticipated 4 per cent then this will jeopardise the prospects for continued buoyancy in the textile sector. In addition, prospects for the sector will hinge on developments in export markets.

Second, the government has not yet articulated its policy for restoring the sugar cane crop, leading to greater utilisation of capacity in the sugar industry. Based on the experience of 1998 it is hoped that the procurement price of sugar cane will not be raised out of proportion with prevailing world prices of sugar.

For other industries like cement and steel, growth prospects will hinge on the revival of construction activity in the country. This will depend upon whether the 20 per cent increase targeted in the PSDP materialises or not and whether the fall in interest rates stimulates demand for housing in the country or not. A special risk factor for all industries in 2000-01 is what happens to energy prices. If gas tariffs are enhanced sharply then this will adversely affect in particular the fertilizer and cement industries, while continued inflation in the price of furnace oil will impact especially on the latter industry.

Altogether, conditions in agriculture are too uncertain at this stage, especially in view of the drought, to make any firm projections that GDP growth will reach 5 per cent for the first time next year after a gap of five years. Given the strong agro-based nature of major industries like textiles and sugar, prospects for the industrial sector are also linked to the outcome in agriculture.

Investment

Pakistan has seen a sharp deceleration in investment since 1997-98. The investment rate has plummeted sharply from 19½ per cent in the first half of the decade of the 90s to 15 per cent by 1999-2000, with the decline being more pronounced in public investment. The government anticipates some pick up next year with the investment rate rising to 15.7 per cent. Already,

there are indications that this is happening in the textile sector and if the 20 per cent enhancement in PSDP is achieved then the public investment target should be attained.

In addition, significant fiscal incentives have been announced in the budget including a 10 per cent tax credit for BMR and abolition of the wealth tax. It is also proposed to counter the negative impact on investor confidence of the accountability drive. Further, if interest rates continue to drop then there is a fair chance that domestic entrepreneurs will begin searching for new investment opportunities. However, the loss of confidence of foreign investors in Pakistan is deep and long lasting in character. The lack of resolution and potential worsening of the dispute with HUBCO could adversely affect the climate further.

On the balance, however, if the budget succeeds in restoring macroeconomic stability and the government is able to establish its credibility with regard to the continuity of its policies then the target of increase in the overall investment rate in 2000-01 by 0.7 per cent of the GDP looks attainable.

External Sector

Developments in the external sector of Pakistan are vital from the viewpoint of restoring the viability of the balance of payments. The current account deficit has been contained at 2.8 per cent (or $ 1700 million) of the GDP in 1999-2000 despite an enormous increase in oil prices by renewed growth in exports of almost 11 per cent, large kerb market purchases (of over $ 1800 million) by the SBP and presence of the Saudi oil facility.

The government proposes to bring down both the trade and current account balance to about $ 1300 million (equivalent to 1.9 per cent of the GDP) in 2000-01. The level of exports has been pitched at $ 9.2 billion (see Table 4), implying, more or less, the same growth rate as this year.

However, the Trade Policy announced on the 28th of June 2000 targets for exports of $ 10 billion, a jump of almost 15 per cent over the current year's level. This will require favourable conditions in world markets, larger exportable surpluses at home and quick success in diversifying the product mix and markets for exports. Both the Budget and the Trade Policy rightly focus on the need for a flexible exchange rate policy and institutional improvements to facilitate exporters. But the goal of achieving the $ 10 billion level of exports has eluded Pakistan for the last many years. Will 2000-01 be the year when we finally make it? The Annual Plan anticipates a major break through in value added textile exports next year. Given the uncertainties associated with the next cotton crop and the intensely competitive conditions in international markets it is difficult to say at this stage whether the $ 10 billion target for exports will be achieved next year or not.

TABLE 4
MAJOR EXPORTS

(in US $ Millions)

	1998-99	1999-2000	2000-2001	Growth Rate 1999-2000 (%)	Growth Target 2000-01 (%)
Primary Commodities	536	688	752	28.36	9.30
• Raw Cotton	2	101	112	4291.30	10.89
• Total Rice	533	587	640	10.13	9.03
Cotton Based Manufactures	4539	4940	5700	8.83	15.38
• Yarn	945	1020	1192	7.94	16.86
• Cloth	1115	1163	1337	4.30	14.96
• Ready Made Garments	651	732	842	12.44	15.03
• Hosiery	742	825	849	11.19	2.91
• Made-ups	1044	1155	1328	10.63	14.98
Other Traditionals	901	965	1049	7.10	8.70
TOTAL (FOB)	7528	8334	9262	10.71	11.14

Source: Annual Plan 2000-2001.

The growth in imports is expected to be contained to below 4 per cent next year (see Table 5). The Annual Plan targets for modest growth in edible oil imports while the bumper crop of wheat will eliminate the need for any imports and wheat will actually be exported for the first time. The commissioning of PARCO refinery could reduce imports of petroleum products significantly while increasing the crude oil imports, resulting overall in some foreign exchange savings. The Annual Plan also targets for a 15 per cent increase in imports of capital goods, as private investment is expected to pick up next year. Altogether, the rate of growth of imports will depend upon the rate at which aggregate demand increases in the economy. If the economy

TABLE 5
MAJOR IMPORTS

(in US $ Millions)

	1998-99	1999-2000	2000-2001	Growth Rate 1999-2000 (%)	Growth Target 2000-01 (%)
Edible Oil	824	454	483	-44.91	6.39
• Palm Oil	597	293	309	-50.94	5.46
• Soyabean Oil	226	161	174	-29.04	8.07
POL	1477	2852	3143	93.09	10.20
• Crude Oil	414	791	1400	91.06	76.99
• POL Products	1063	2061	1743	93.89	-15.43
Fertilizer	265	170	174	-35.85	2.35
Capital Goods (Value)	3238	3350	2850	3.46	-14.93
All Others	4246	3997	4833	-5.86	20.92
TOTAL (FOB)	9613	10196	10566	6.06	3.63

Source: Annual Plan 2000-2001.

begins to show a robust growth rate close to the target of 5 per cent then the target of 3 per cent growth in imports begins to look conservative.

As far as the prospects for the current account of the balance of payments are concerned the reduction in deficit by over $ 400 million will hinge on the buoyancy of home remittances and on whether the SBP will be able to continue making large purchases of foreign exchange in the kerb market or not. The recent onset of speculation in the currency and the slide of the rupee in the kerb market in parallel with a downward movement of the inter-bank rate and declining foreign exchange reserves, provide initial indications that this policy will be more difficult to pursue next year, in which case the target current account deficit of 1.9 per cent of the GDP or $ 1.3 billion looks low.

Monetary Sector

The rate of inflation dipped to virtually an all-time low of 3.4 per cent in 1999-2000. This is attributed, in particular, to the extremely low rate of monetary expansion, improved supply position in the case of some key food items and steep fall in international prices of commodities like edible oil and tea. But as argued in a subsequent note, there is a component of suppressed inflation due to the conservative policy followed by the government with regard to adjustment in some administered prices. Although, the wheat procurement price was raised by 25 per cent there has been no corresponding enhancement in the issue price. The steep rise in petroleum prices internationally has not been fully transmitted into domestic retail prices, especially in the

case of furnace oil. Electricity tariffs have been held constant despite a large increase in the price of furnace oil in recent months. Gas tariffs will need to be raised sharply to attract private investment into the sector. The exchange rate has been held nominally stable for the better part of 1999-2000 but there are indications now that the government will pursue a more flexible exchange rate policy and the currency will be allowed to depreciate gradually. Therefore, if the government is compelled to make all these adjustments early in 2000-01 then, alongwith with the expected faster rate of monetary expansion of 9 per cent, it seems unlikely that the rate of inflation can be restricted to 4½ per cent and it could rise to about 6 per cent.

Altogether, it is still too early to say if we will see a strong recovery of the economy in 2000-01, with the growth rate rising to 5 per cent and the manufacturing sector putting in a much stronger performance. A lot will hinge on conditions in agriculture, especially in view of the drought. If both cotton and sugar cane crops are good, given the forward linkages, then the prospects look good for a 6 per cent growth in the manufacturing sector. Expectations are that the investment rate will improve somewhat but the outlook for the balance of payments is uncertain and much will depend on whether we come close to achieving the export target of $ 10 billion and if SBP is able to continue making large kerb market purchases of foreign exchange. Finally, the prospects are for a significant pick up in the rate of inflation, possibly upto 6 per cent next year.

WHAT EXPLAINS THE FALL IN THE INFLATION RATE?

By

Dr. Sajjad Akhtar, Mansoor Ahmed and Kalim Hyder

A startling feature of 1999-2000 economic performance is that inflation as measured by the consumer price index at 3.4 percent is the lowest in the last two decades. What factors contributed to this low inflation rate in the country?. Is it low food, non-food or imported inflation? Was the inflation purposely suppressed by not adjusting administered prices of food, energy and its derivatives, i.e., electricity? Was it the deficiency in aggregate demand relative to aggregate supply that kept the lid on prices? In other words were recessionary conditions responsible for low inflation? Is the fall in inflation rate structural or temporary in nature?

In absence of any independent research and data agency that could produce yearly estimates of inflation, researchers have to rely on simple statistical estimation which model the main determinants of inflation. However estimates and forecast based on statistical techniques are not superior substitutes to estimates based on hard numbers collected through primary data collection. Social Policy and Development Centre has modeled changes in GDP deflator (an indicator of overall inflation in the economy) in which, demand relative to supply in the economy (measure of demand pressures in the economy), money supply, burden of indirect taxes on the manufacturing sector, imported inflation and inertia in inflation, i.e., last year inflation have a positive impact on/or increase inflation. These were modeled on the basis of established macro theory and last 26 years data i.e., 1973-1998 of the national economy. Putting in the actual numbers given in the Economic Survey for 1999-2000, our model estimates that the increase in GDP deflator for the 1999-2000 should have been 5.4 percent as compared to 2.9 percent increase in GDP deflator as stated by the government. The contribution of various determinants as estimated from the SPDC model is given in Table 1.

TABLE 1
DETERMINANTS AND THEIR CONTRIBUTION TO INFLATION IN 1999-2000

(Percentages)

Money Supply as Ratio Of Real GNP	-0.90
Unit Value Index of Imports	3.85
Inflationary Expectations (Adaptive)	2.14
Indirect Taxes As ratio of Nominal Value Added in Manufacturing	0.21
Real Demand Relative To Real Supply	0.55
TOTAL	**5.35**

Source: Social Policy & Development Centre, I S P M unit

Table 1 indicates that while higher prices of imports (specifically oil imports prices) and inertia in past inflation jointly contributed about 6 percentage points to current inflation, lower growth in money supply (3.2 percent in the first nine months as compared to the targeted 8.8 percent for the whole year) had deflationary impact on prices to the tune of 1 percentage point. Combining the inflationary impact of indirect taxes and minuscule impact of demand conditions the net rate of inflation estimate comes in the vicinity of 5.4 percent for the year 1999-2000.

The reason for this apparent deviation between our and government estimates is not the weakness in the model as it accurately tracks the historical period. Technically a temporary or a single year blip occurred in 1999-2000 as government failed to allow the pass through affect of higher imported inflation as well increase in the support price of wheat on the domestic inflation. One may also assert that in order to cash on the 'poverty bandwagon' and keep its popularity intact it became overzealous in holding the domestic inflation. Historically and specifically during the last decade this was not the case as evidenced by high inflation rates in the early and mid nineties.

Moreover a lower money supply was essentially a spin-off benefit from the debt rescheduling agreed in Jan 1999. How? Theoretically budget deficit is financed by three sources, net external financing, domestic bank and non-bank borrowing. Postponement of servicing of foreign debt meant that foreign assistance received during 1998-99 and 1999-2000 was larger in net terms.

Correspondingly the government therefore had to rely less on domestic bank borrowing which is inflationary. There is considerable direct evidence from government's documents to support the above reasoning for lower inflation rate in the current year.

Although unit value index of imports increased by 16.2 per cent in 1999-2000, largely on account of increase in the petroleum prices, yet the CPI for fuel, lighting and lubricant which comprises of electricity, gas and POL products increased by 4.5 per cent during the same year. This clearly indicates that the government did not transfer the burden of higher international oil prices to the consumer. This suppression of domestic inflation also took its toll on the government budget. There was reduction in surcharges and increase in grants to WAPDA and KESC. The petroleum surcharges declined during 1999-2000. This was at least partially due to the reduction in the overall tax incidence. In a similar manner, government provided subsidies to compensate KESC and WAPDA for the reduction in the tariff rate of electricity. The total subsidies to these power distribution institutions were Rs 7.4 billion in the year 1999-2000. Another piece of evidence is that in spite of 25 percent increase in wheat support price, food index just climbed by 2 percent during the year as issue price of atta wasn't correspondingly adjusted.

The lower increase in money supply was the result of two reinforcing phenomena:- a) lower private credit demand due to uncertainty in political and macro environment and loss of investor's confidence. The net increase in the private credit in the first nine months of 1999-2000 was Rs 34.7 billion as compared to Rs 70.6 billion in the corresponding period of last year; b) due to debt rescheduling net external borrowing of the government increased in the 1998-99 and 1999-2000. It was Rs 146 billion and Rs 79 billion respectively. Correspondingly the demand for domestic bank borrowing (a main factor in causative changes in the money supply) fell. In 1998-99 the government retired past domestic debt to the tune of Rs 73.8 billion and 1999-2000 it was an increase of Rs 18.4 billion. In the 3 years prior to re-scheduling the bank borrowing has ranged from Rs 50 to Rs70 billion annually. Thus the lagged affect of a fall in the growth of money supply through reduced bank borrowing on current year's inflation cannot be ignored.

Forecasting is a risky venture, but nevertheless it is tempting to look into our black box and reveal what it says about the next year's inflation. The assumptions that go behind in generating the number for 2000-01 are crucial and need to be mentioned:- i) in line with the government

projections, we assume that supply of M2 will grow by 9 percent in the 2000-01. This presupposes that aided by low interest rates, easy monetary policy will be more successful than it was last year; ii) we assume that aggregate demand relative to aggregate supply pressure will be more evident in the economy this year than last year provided the enhanced ADP is implemented. Thus we assume that the ratio of aggregate demand to supply will be higher by 4 percent this year; iii) as per the targets set by the government we assume that manufacturing sector and nominal GDP will grow by 5.9 percent and 9.5 percent (inflation 4.5 percent plus 5 percent real growth), respectively; iv) indirect taxes as per budget documents are estimated to grow by 21 percent, and v) index of unit value of imports will grow by 12 percent. We expect the dollar value of imports to rise in the historical range of 4-6 percent, while the rest can be attributed to the adjustment in the exchange value of the rupee. Let us add that the estimates of inflation and legitimately so, are very sensitive to the assumptions of devaluation and the dollar value of imports. The forecasted increase in next year GDP deflator is 4.35 percent. Allowing for 5 percent margin of error the model predicts that it will lie in the range of 5.05 and 3.65 percent. This of course once again assumes that government will pass on the impact of devaluation to the final consumer.

Forecasting, if not complimented by logical and rational perceptions or judgements can be termed as quantitative jugglery. Just as our model over predicted the change in GDP deflator for 1999-2000, we have reason to suggest that it is under predicting overall inflation for the coming year as technically, inflation inertia , or this year's low inflation also pulls down the next year's inflation rate. In all likelihood suppressed inflation will have to catch-up in the 2000-01. Gas prices are likely to be substantially revised upward early in the year. There is also a commitment by the government to raise the issue price of atta in line with the increase in last year's support price. One also needs to be aware of the implications on inflation in case the expected second round re-scheduling does not materialize. The government will then have to resort to heavy bank borrowing in order to compensate for the dramatic fall in net external borrowing to finance the deficit.

All in all, given the component of suppressed inflation this year, a faster rate of depreciation of the rupee, stronger demand conditions in the economy, more rapid increase in money supply and some imported inflation, we will not be surprised if next year the rate of inflation approaches 6 per cent.

BALANCE OF PAYMENTS SCENARIO IN 2000-01: TRANSPARENCY AMIDST UNCERTAINTY?

By

Imran Ashraf Toor and Mansoor Ahmed

In the immediate aftermath of Budget 2000-01 a lot of questions have been raised about the feasibility of external financing for the coming fiscal year. The concerns are legitimate as the IMF program failed to materialize by end June 2000 in contrast to repeated announcements of agreement/understanding earlier by the Finance Minister. These apprehensions are further reinforced by the concerns that the debt rescheduling period will end by December 2000 and negotiations for the supposedly second round of rescheduling have not even begun. Meanwhile, the short and medium term fragility of balance of payments is assuming a proverbial stance.

Releasing the projected balance of payments scenario for 1999-2000 (provisional as it may be) and 2000-2001 in the Annual Plan under these uncertainties is again a credit to the government in ensuring transparency and accountability in economic decision making. The questions of interest are:- What is the feasibility of implied projections of trade and current account deficit for the 2000-01? To what extent the BOP numbers account for presence or absence of reliefs expected from second round of rescheduling as well inflows through the much touted Poverty Reduction and Growth Fund (PRGF) facility? Is the BOP for 2000-01 consistent and on-track with the target of current account deficit of 0.5 percent of GDP for the year 2002-2003?

Let us briefly compare the actual performance of the economy in balancing its external accounts with those projected for 1999-2000. Table 1 and 2 re-arranges the BOP numbers given in the Annual Plan to facilitate an economic analysis. Against the projected deficit trade balance of $1.2 billion actual trade balance was $1.86 billion, nearly 55 percent higher. Actual exports were marginally lower while import bill was higher by 7 percent against the projected figures. The deviation between planned and actual financing of this trade deficit is more revealing. The State Bank had planned kerb market purchases of $0.8 billion but ended up buying or sucking up $1.8 billion. State Bank of Pakistan must be commended for successfully walking a tight rope between stabilizing foreign reserves and not pushing the open market rate beyond the 5 percent deviation up until recently. Interestingly actual transactions on the capital account remained in

TABLE - 1
SUMMARY OF CURRENT AND CAPITAL ACCOUNTS OF THE BALANCE OF PAYMENTS

($ Million)

	1998-99 Actual	1999-2000 Plan Target	1999-2000 Actual/Prov	2000-01 Projection	2001-02	2002-03'
Current Account Deficit (-) / Surplus (+)	-2381	-1360	-1695	-1260	n.a.	-355
Capital Account Deficit (-) / Surplus (+)	-581	-2763	-2717	805	n.a.	n.a.
Exceptional Financing	3966	5132	4089	1825	n.a.	n.a.
Change in Foreign Exchange Reserves (Decrease(-)/Increase(+))	1004	1009	-323	1370	n.a.	-355

' The three year macroeconomic framework targets for foreign exchange reserves at 3 months of imports by the end of 2002-03
Source: Annual Plan 2000-01
n.a. = Not available

TABLE 2
CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

($ Million)

	1998-99 Actual	1999-2000 Plan Target	1999-2000 Actual/Prov	2000-01 Projection	2001-02	2002-03
Trade Balance	**-2085**	**-1202**	**-1862**	**-1304**	**-324**	**791**
Exports (f.o.b.)	7528	8346	8334	9262	10559	12000
Imports (f.o.b.)	9613	9548	10196	10566	10883	11209
Invisible Balance	**-296**	**-158**	**167**	**44**	n.a.	**-1146**
Services (Net)	-2570	-2692	-2890	-2818	n.a.	n.a.
Private Transfers (Net)	2274	2534	3057	2862	n.a.	n.a.
Home Remittances	1060	1200	950	1100	n.a.	n.a.
Resident FCAs	539	533	290	135	n.a.	n.a.
Others	675	801	1817	1627	n.a.	n.a.
Current Account Deficit (-) / (Surplus (+)	**-2381**	**-1360**	**-1695**	**-1260**	n.a.	**-355**
Capital Account Deficit (-) / Surplus (+)	**-581**	**-2763**	**-2717**	**805**	n.a.	n.a.

Source: Annual Plan 2000-01.

line with the projections. As per figures this year will see a drain of $323 million from the reserves against the projected build-up of a billion dollars due partly to lower exceptional financing of a billion dollars and a larger current account deficit. One can also visualize that if the option of kerb purchases was unavailable to us, the current account deficit would have

doubled from 2.8 percent on the GDP in 1999-2000 and led to a severe haemorrhaging of reserves by now now.

The real part i.e., the trade part of BOP projections for 2000-01 present an interesting dilemma for the analyst as well indicate the absence of coordination in BOP planning among the relevant ministries within the government. While the Annual Plan based its current account estimates on 11.1 percent growth in exports, the Ministry of Commerce assumes more than15 percent growth in exports to achieve a target of $10 billion for the next year. The question is who to take seriously? We assume Annual Plan targets to be more realistic. However the growth in imports falling from a 6 percent in 1999-2000 to 3.9 percent in 2000-01, when the GDP growth rate is assumed to pick up from 4.5 percent to 5 percent is difficult to justify and is clearly based on stability or some fall in oil prices. The assumptions in trade sector reduce the trade deficit from $1.8 billion to $1.3 billion. However, we continue to depend on kerb market purchases to the tune of $1.6 billion next year to finance part of invisible payments and bring down the current account deficit to $ 1.3 billion. Roughly the same level of interest payments as in the current year are an indication that the government expects the second round of rescheduling to materialize and may be mentally prepared to accede to the political and economic conditionalities that such an agreement entails.

The projections in capital account of BOP are even more revealing. We have a surplus of $0.8 billion next year against a deficit of $2.7 billion in the capital account along with the build-up of $1.37 billion in reserves during the next year. How will this turnaround come about?. Roughly, it seems we expect program aid to increase from $125 million to $800 million. This is the expected World Bank/IMF program which the Governor State Bank of Pakistan talked about as the doubtful component. We expect inflow on private account to increase from $156 million in 1999-2000 to double to $ 332 million in 2000-01. This restoration of private confidence partly depends on the resolution of IPPs issue and success of privatization efforts. Moreover as a result of London club rescheduling we expect an outflow of only $55 million in 2000-01 as against $936 million witnessed during 1999-2000.

Clearly our BOP is fragile and BOP planners face tough choices, even in the short run. In accepting the IMF program we might have to choose between the $800 million aid and devaluation versus the $1.6 billion from the open market. The apparent benefits of access to the open market are slowly dissipating and the costs of instability in the exchange market may outweigh the costs of entering into a more permanent arrangement of external financing offered by the multilaterals. But in that case the uncertainty of financing a gap of $1.6 billion even with the Fund program will still remain.

Just a brief mention of implications on BOP accounts of setting a current account deficit target of 0.5 percent of GDP for the year 2002-2003. We estimated that at the projected rates of growth of the economy it implies a current account deficit of only $355 million in year 2002-2003. In other words a decline of nearly 80 percent in a matter of three years from the current level of $1.7 billion. For that to happen there will be net outflow on services account to the tune of $1.1 billion if it is to be consistent with the targets of $12 billion exports and 3 percent growth rate in imports. We leave it to the imagination of the readers to fill the numbers in the capital account for the year 2002-2003.

MACROECONOMIC DEVELOPMENTS AND POVERTY

By
Kalim Hyder

The return of (rapidly increasing) poverty in Pakistan during the last few years is increasingly being recognized by government, donors and civil society at large as perhaps the principal problem which needs to be tackled on a top priority and urgent basis if a large-scale social breakdown is to be averted with its concomitant implications on law and order. In light of this recognition, the military government has recently announced in the budget the elements of a poverty alleviation strategy, which include a focus on employment generation via a public works program and expanded micro credit and on helping the chronically poor through larger *Zakat* subventions and a food stamp scheme. Credit is due to the government for articulating a poverty reduction strategy for the first time and putting poverty alleviation high on the policy agenda.

However, it needs to be emphasized that while social safety nets can begin to mitigate against the worst manifestations of poverty, the overall poverty outcome in the country hinges crucially on broader macroeconomic developments relating to key determinants of poverty like the growth in real per capita income, rate of unemployment, level of cost of living (especially as reflected in food prices), etc. In other words, if the economy does not revive quickly and incomes and employment do not rise rapidly then directly targeted efforts at poverty alleviation through social safety nets are unlikely to be successful in counteracting the underlying increase in poverty. As such, priority must continue to be attached to pursuing a strategy of growth with social justice, through focus on employment generation and reduction in income inequality.

Past Trends

The latest Economic Survey published by the Ministry of Finance indicates that while poverty had been substantially contained during the decade of the 80s it has risen sharply in the 90s. The incidence of poverty was 22per cent in 1990-91, current estimates are that it is close to 33 per cent. Much of the increase can be attributed to adverse macroeconomic developments during the current decade. To start off with, there has been a visible decline in the growth momentum of the economy during the decade of the 90s. The 80s saw a steady growth rate of 6 per cent which fell

to 5 per cent in the first half of the decade of the 90s and declined further to 4 per cent in the second half of the decade. Last year it was only 3 per cent and this year, 4½ per cent. Consequently, the rise in real per capita income has tapered off. It increased annually by almost 3 per cent during the decade of the 80s, but during the last four years there has cumulatively been an increase of only 1 per cent in this indicator.

The primary reason for the falling growth rate is the declining level of investment and savings in the economy. From the peak level of 18 per cent of GDP, fixed investment has fallen to just above 13 per cent by 1999-2000. This is a reflection of the declining level of national savings and difficulties in access to foreign savings.

The rate of inflation remained single digit throughout the 80s. It rose sharply to over 11 per cent in the first half of the decade of the 90s but has moderated somewhat in the second half. Inflation in 1998-99 and 1999-2000 at 6 per cent and 3½ per cent respectively is very low by historical standards due to less imported inflation, restricted monetary expansion (due to domestic debt retirement facilitated by the external debt relief) and control over administrative prices. It is significant to note that food prices have generally risen more rapidly than the overall consumer price index, except this year.

Unemployment has increased in the 90s in relation to the 80s by about two percentage points. This is a reflection not only of continuing rapid growth in the labor force due to the high underlying rate of population growth and resulting concentration of the population in the younger age brackets but also as a consequence of the fall in the growth rate of the economy. Given all these negative macroeconomic trends, it is not surprising that while poverty fell in the 80s it has started rising rapidly in the 90s.

Outlook For Poverty

The last available estimate of the incidence of poverty is that of 32.6 per cent (or 43.3 million people) in 1998-99. Have the conditions of poverty likely to have deteriorated or improved in 1999-2000, the year which is just about to come to an end ? What are the prospects for poverty

reduction in 2000-01 if the macroeconomic targets set in Annual Plan are achieved? The objective of this note is to attempt at least a tentative answer to these questions.

For poverty forecasting, it is essential to have estimates of the quantitative contribution of different macro determinants to changes in the incidence of poverty on the basis of historical analysis of the relationships. Research at the Social Policy and Development Centre reveals the importance of the following factors in influencing the level of poverty:

- level of real per capita income
- extent of unemployment
- level of food prices
- level of real per capita home remittances
- human capital endowment of the labor force

The year, 1999-2000, has witnessed some favourable developments with regard to the impact on poverty. Real per capita income which had been falling continuously since 1996-97 has showed positive growth for the first time of over 1½ per cent. Of significance also is the distribution of additional incomes in the economy. Almost one thirds of the increased real incomes in the economy has accrued to farmers. While the income effect of the bumper crop of cotton was neutralized by the steep fall in prices, wheat growers not only enjoyed a close to 4 per cent improvement in their yields but also received substantial higher prices due to the 25 per cent increase in procurement price announced by the government. Altogether, the 5½ per cent growth in agriculture in 1999-2000 must have contributed to some rural poverty alleviation.

The implications of macroeconomic trends in 1999-2000 an urban poverty are less favourable. The large-scale manufacturing sector registered a zero growth rate although textiles, a relatively more labor-intensive sector, performed well. Perhaps more importantly, we have been informed that the small scale-manufacturing sector is no longer as buoyant as it used to be. The annual growth rate of the sector is now estimated to be 5.3 per cent as apposed to 8.4 per cent in the early 80's. Since the small-scale sector is a major employer of the less skilled category of workers, this has major implications on the process of labor absorption in the country.

Given the fact that especially in the second half of the decade of the 90's the manufacturing sector has performed poorly while agriculture has shown relative buoyancy it seems reasonable to conclude that the gap between urban and rural poverty is narrowing over time. It needs to be emphasised that fast growth of poverty in the urban areas of the country has even more direct implications potentially on the law and order situation.

As emphasized above, the unemployment situation has an important bearing on poverty. Fortunately, with the rapid increase in agricultural output in 1999-2000 labor demand has probably been relatively strong in rural areas, although the long run implications of changes in tenurial status and the process of mechanisation that is going on agriculture may be having adverse implications an labor absorption in this sector.

Labor market conditions are also aggravating very rapidly in the urban areas. The government, including the vast array of autonomous bodies, attached departments, statutory corporations and public enterprises, had traditionally constituted a major source of employment, especially for the more educated. This source has, more or less, dried up in recent years due to the fiscal squeeze and as part of economy drive recruitment bans have frequently been announced. The steep fall in private investment, especially in the last two years, has limited the expansion in employment opportunities. The prospect of substantial 'downsizing' in major government entities implies that the process of labor displacement will increase further.

Therefore, while the short-run employment situation has improved somewhat in the rural areas in 1999-2000 due to buoyant agricultural output, it has clearly worsened in the urban areas. On top of all this, there is evidence that the informal economy, which has acted as the residual sector for absorption of the unemployed unskilled workers, is also running out of steam.

Turning to the level of food prices, this is one area where considerable success appears to have been achieved in 1999-2000. During the first nine months of the current fiscal year, food prices have gone up on an annualised basis by only 2 per cent, according to the FBS. This is the lowest rate of inflation in decades and highlights the fact that the cost of living has gone up only modestly during the year. Food prices are of vital importance to the poor and the success achieved in restricting the increase in these prices is probably the first major achievement by

government in limiting the growth in poverty. Clearly, relative food price stability will have to remain one of the major planks of the poverty reduction strategy.

A negative development from the viewpoint of poverty is the fall of almost 10 per cent in workers' home remittances in 1999-2000. Perhaps, the overall inflow has not fallen so much and a larger part may have been diverted into unofficial channels. But, the continuing decline in home remittances is an adverse long term factor from the viewpoint of poverty and has made a significant contribution to the increase in incidence of poverty during the 90s.

Altogether, positive developments during 1999-2000 with regard to poverty are the modest rise in real per capita income after falling for a number of years and the extreme moderation in the rate of inflation in food prices. As against this, negative developments are the continued worsening of the unemployment situation, especially in the urban areas, and a steep fall in home remittances.

Based on the changes in macro determinants of poverty during 1999-2000, SPDC's poverty forecasting model reveals that there has probably been only a relatively small deterioration in the overall incidence of poverty of about 0.7 percentage point this year. Consequently, the number of poor has increased by about 0.9 million. Although the model does not forecast urban and rural poverty separately, there is evidence that urban poverty has increased more rapidly in 1999-2000. It needs to be stated that poverty measurement and forecasting still remains an inexact science in Pakistan and that SPDC's estimates must only be taken as indicators of the orders of magnitude.

For 2000-01, the outlook for poverty looks encouraging if the Annual Plan targets, of 5 per cent growth (implying about 2 ½ per cent growth in real per capita income) along with containment of the rate of inflation to 4 ½ per cent and restoration of the buoyancy in home remittances, are achieved. Such high growth and relative price stability coupled with the expanded social safety nets proposed to be put in place by the Budget can create a situation where for the first time in 2000-01 after a gap of many years, the rise in the incidence of poverty can be arrested and hopefully reversed in subsequent years.

BUDGETARY IMPERATIVES AND STRATEGY

By
Dr. Hafiz A. Pasha

The Budget 2000-01 is the first budget of the military government which has placed economic revival as one of the key objectives of its agenda of governance and reform. It is also the first budget to be presented in the context of a potentially new program for balance of payments support by donors, discussions on which are on-going with the International Monetary Fund. It is essential that such a program be put in place prior to the end of the period of debt rescheduling in December 2000, to avert difficulties in international payments thereafter.

The objective of this article is to highlight the imperatives, both macroeconomic and fiscal, which were operative in influencing the nature of the budget for 2000-01. The resulting implications for the appropriate budgetary strategy to address these imperatives and concerns are brought out. This is followed by an analysis of how the budget that has been announced differs from the proposed strategy and to what extent it is likely to be successful in meeting the various objectives that the government has set for itself.

Budgetary Imperatives

Budgetary imperatives are both more broadly macroeconomic and more narrowly fiscal in nature. Perhaps the most important macroeconomic consideration at this time is to bring about the process of sustained economic revival. During the last five years the economy has averaged a growth of only about 4 per cent as compared to 5 per cent in the first part of the decade and 6 per cent earlier in the decade of the 80s. This year the expected growth is about 4½ per cent, achieved largely on the back of a strong agricultural performance. Of particular concern is the loss of dynamism of the large-scale manufacturing sector which had traditionally acted as the ‘engine of growth’. During the last few years this sector has shown a growth rate of only 2½ per cent and it is expected that this year it will demonstrate zero growth, despite visible buoyancy in the textile sector.

One of the consequences of the loss of growth in the economy has been rapidly increasing poverty. Slowly rising or stagnant real per capita incomes, high rates of inflation till recently and rising unemployment rates have driven a larger proportion of the population below the poverty line. At the beginning of the decade of 90s one in five families was poor, by the end of the decade this had risen to one in three families. There is a need for government to step in with wider and deeper social safety nets quickly if a large-scale social breakdown is to be averted.

It is also clear that fiscal policy will have to play a leading role in the process of economic revival. Since January 99, following the debt rescheduling, an expansionary monetary policy has been pursued with prime emphasis being placed on bringing down interest rates in order to stimulate private investment. But this policy has floundered in the face of shyness of private investors, both domestic and foreign, whose confidence has been eroded by the actions taken in the aftermath of the nuclear blasts and sanctions and more recently by the accountability drive. Lower interest rates have not been able to spur private investment on in a climate of low business confidence.

It is at times like this, when monetary policy has largely failed, that the role of fiscal policy becomes crucial. It has to play the prime role in stimulating the economy either by drastically raising the level of public spending, especially public investment, and / or bringing down the level of tax rates in the economy. It is expected that due to the consequential rise in aggregate demand, the economy will be able to emerge from the recession and provide signals of higher profitability which could help in overcoming the shyness of potential investors.

Therefore, given the strong commitment to the process of economic revival it was expected that the government would use the budget, which is the prime instrument of fiscal policy, to jump-start the economy by pushing for a quantum increase in the level of development expenditure, by targeting tax breaks towards sectors with substantial excess capacity and providing fiscal incentives for investment.

As opposed to the vital macroeconomic imperative for economic revival there are some fiscal concerns which could run somewhat counter to this objective. Following the revelation that fiscal deficits had remained high during the last two years and had not been brought down sharply as reported by the previous government, it was clear that importance had also to be attached to the task of macroeconomic stabilisation. Fiscal deficits have remained over 6 per cent of the GDP during the last four years and the likely level of deficit for this year is close to 6.5 per cent.

At this level, there is the danger that if significant net external financing does not become available then the level of domestic borrowing to finance the deficit would be so high as to put severe pressure both on the rate of inflation and interest rates which would tend to 'crowd out' the private sector. In addition, continuing large fiscal deficits would imply rapid accumulation of public debt, both domestic and foreign, which has already approached 100 per cent of the GDP. The resulting implication of the rising level of debt servicing would be that high priority expenditures would be further crowded out of the budget and Pakistan's balance of payments would become even more unsustainable. Therefore, a key budgetary imperative was to reduce the debt burden by containing the size of the fiscal deficit.

Another important consideration, which has perhaps not been emphasised as much, is the need to arrest the simultaneous erosion in debt repayment capacity alongwith the rapid growth in debt. This erosion has occurred because an increasingly larger share of borrowing has gone to finance current consumption by the government. The result is that incomes have not grown fast enough in the economy to generate the additional revenues to service the higher debt. During the current year, if the fiscal deficit ends up at about 6.5 per cent of the GDP while the development expenditure remains restricted to 3.2 per cent of the GDP, then this implies that half the borrowings will be used to finance development and the other half to meet the current consumption needs of the government including expenditures on civil administration, defence, economic and social services, etc. Clearly this is not a sustainable situation and highlights that, sooner or later, we will move to a state of bankruptcy.

It has, therefore, become essential to ensure as one of the cardinal principles of prudent fiscal management that whatever borrowings are made are used only for financing the expansion in the productive capacity of the economy. This will require elimination of revenue deficits in the budgets, which currently exceed 3 per cent of the GDP. In other words, as rapidly as possible, the current budget of the government must be balanced, with revenues financing all the current expenditure needs.

The issue then is one of how the revenue deficit can be eliminated. Should we follow an aggressive resource mobilisation strategy and try and raise the tax-to-GDP ratio sharply at a time when it has shown a tendency to fall in recent years or should the maximum focus be on containment of current expenditure, where there are apparently some downward rigidities created by the nature of such expenditures? There is the basic problem that raising the burden of taxation on an economy which is in a state of recession could lead to a further contraction of economic activity. Therefore, the resource mobilisation strategy has to be very carefully designed so as to minimise dislocation, especially of the large-scale manufacturing sector. Clearly, the emphasis will have to be on broadening the tax base to hitherto undertaxed sectors, to minimising tax evasion and to simplifying the tax system so as to reduce the compliance costs of tax payers.

Altogether, the government had the enviable task of producing a budget which could balance potentially conflicting objectives like achieving economic revival on the one hand and macroeconomic stabilisation on the other. Superimposed on all this was the need to agree on a set of macroeconomic targets and a strong reform agenda with the IMF in order to qualify for the much needed balance of payments support beyond December 2000. The Fund has changed its stance in recent times in its dealings with developing countries, due both to internal and external criticism, and there has been much more talk on focusing on poverty reduction and growth rather than the conventional stabilisation program involving the cutting down of fiscal and current account deficits.

A Possible Strategy

Given the mutually conflicting objectives of economic policy making at this time, I had proposed a strategy which could minimise the potential trade offs and lead to the extent possible to the balanced achievement of the different objectives. The key elements of such a strategy were captured in the so-called *'50 : 50 Formula'*.

What is this 50 : 50 formula? The key elements are summarised below:

(i) Given the need to eliminate the revenue deficit to ensure that all future borrowings are for development, ensure that within two years this deficit (of just over 3 per cent of GDP) is brought down to zero, with 50 per cent of the reduction in 2000-01 and the remaining 50 per cent in 2001-02. This would require that the revenue deficit be reduced by about 1.5 per cent of the GDP in 2000-01.

(ii) Reduction of the revenue deficit by 1.5 per cent of the GDP in 2000-01 to be achieved on a 50 : 50 basis by an enhancement in the tax-to-GDP ratio by 0.75 per cent of the GDP and by a reduction in the current expenditure-to-GDP ratio by 0.75 per cent of the GDP.

(iii) Reduction of the revenue deficit by 1.5 per cent of the GDP to be allocated on a 50 : 50 basis for raising development expenditure (including allocations for the poverty alleviation program) and for reduction in the fiscal deficit respectively. This would imply that allocations for PSDP (and the poverty alleviation program) would rise by 0.75 per cent of the GDP while the fiscal deficit would be brought down next year by 0.75 per cent of the GDP.

I felt that the 50 : 50 formula represented the most balanced approach to promoting economic revival and alleviating poverty while simultaneously achieving a degree of macroeconomic stabilisation. It seemed that with the lowest rate of inflation in decades this was the ideal time to push aggressively for a fiscally induced economic revival without worrying too much about the rate of inflation rising to an unsustainably high level.

The Budgetary Strategy

The strategy implicit in the Budget announced by the government for 2000-01 differs in some fundamental ways with the strategy recommended but there are also many similarities. First, the government has chosen virtually the same target for revenue deficit reduction for next year. The revenue deficit of the federal and provincial governments combined is proposed to be brought down by just over 1.5 per cent of the GDP. Therefore, the 50 : 50 formula appears to have been adhered to in this case and hopefully the government will eliminate the residual deficit in 2001-02.

Second, the revenue deficit reduction strategy appears to be, more or less, balanced in line with the 50 : 50 formula. Gross revenue receipts to GDP ratio of the federal government is expected to increase by 0.7 per cent of the GDP while its current expenditure to GDP ratio is expected to fall by 0.9 per cent of the GDP. The improvement in the former is likely to increase the provincial revenue surplus by 0.7 per cent of the GDP and help in reduction of the combined revenue deficit by about 1.5 per cent of the GDP.

Third, the improvement in the revenue deficit position combined with a significant jump in capital receipts will make available about 2.2 per cent of the GDP for either enhancing the level of development expenditure or for ultimate fiscal deficit reduction. It is here where the government's priorities appear to differ fundamentally from the 50 : 50 formula. Bulk of the improvement in the revenue deficit is proposed to be translated into fiscal deficit reduction. As such, the fiscal deficit is proposed to be brought down by as much as 1.9 per cent of the GDP from the present level of 6.6 per cent to 4.7 per cent of the GDP. Simultaneously, development expenditure (including allocations for poverty alleviation) is being raised more modestly by 0.3 per cent of the GDP.

The quantum of fiscal deficit reduction proposed of 1.89 per cent of the GDP has been surpassed only once before in 1993-94 (deficit reduction of 2.1 per cent of the GDP) when development expenditure was slashed by 1.2 per cent of the GDP and defence expenditure was curtailed by 0.7 per cent of the GDP, neither of which is proposed in 2000-01. The heavy emphasis that is being placed on fiscal deficit reduction indicates clearly that the government has opted for

macroeconomic stabilisation in preference to economic revival. Therefore, the message is clear. The Budget for 2000-01 is a 'stabilisation' budget and not a 'revival' budget.

While the government's decision to opt for the stabilisation objective must be respected and demonstrates fiscal prudence on the part of economic managers, it is not clear how much of the choice is truly 'homegrown'. It is possible that the IMF mission, which was in Pakistan just prior to the announcement of the budget, may have insisted on stronger fiscal deficit reduction. Given the need to get the IMF on board, it is possible that the economic managers acceded to this demand and in the process affected the prospects for early economic revival. Perhaps, the incremental allocations, in particular, for the welfare payments (*Zakat* and food stamps) had to be curtailed to meet the stiff deficit reduction target. If, in fact, the deficit target of 4.6 per cent of the GDP was set on the insistence of the IMF, then it is clear that the Fund has backtracked on its commitment to give Pakistan a program which is oriented more towards growth and poverty reduction.

Beyond the broad public finance aggregates there are some aspects of the budgetary strategy which need to be highlighted. First, within the context of the overall resource mobilisation strategy which involves an enhancement in the federal gross revenue receipts to GDP ratio by 0.70 per cent of the GDP, exclusive reliance is being placed on raising the tax-to-GDP ratio by as much as almost 1.5 per cent of the GDP next year. This is a very large increase and has seldom been achieved before. Most experts have expressed doubts about the feasibility of achieving the tax revenue target. An indication can be had of the enormity of task when we realise that the government is asking the people of Pakistan to hand over 27 paisas as their additional tax contribution out of every extra rupee of income that they make next year. However, credit is due to the government for having adopted the right resource mobilisation strategy in the prevailing economic conditions. The focus is on effective broad-basing of the tax system and reducing tax evasion rather than on enhancements of tax rates. The government must also be complimented for having pursued the tax survey and the process of documentation of the economy with resolve and determination. It is beginning to succeed in a critical area where previous governments had failed.

Unfortunately, non-tax revenues have started collapsing. They are expected to fall even in nominal terms next year. State Bank of Pakistan's net profit contribution is falling sharply because of large kerb market purchases at premium and the decline in interest rates on T-bills. More importantly, the contribution of public corporations and utilities has diminished and as many of them have run into financial difficulties the government is increasingly having to absorb their losses by converting their debt into equity. Clearly, the viability of major entities like KESC, WAPDA, PIA, Pakistan Steel Mills, Railways, etc. will have to be restored on a war footing. Their collective burden on the exchequer as reported by the Finance Minister is a colossal Rs 60 billion. The budget is disappointing in that no specific measures are proposed for improving the workings of these entities.

Second, within the context of expenditure containment almost exclusive emphasis is being placed on reducing the costs of debt servicing by bringing down interest rates (by 1½ percentage points on NSS). In fact, while domestic debt is expected to continue growing, interest payments are actually expected to fall!

The lack of containment of current expenditure, besides interest payments, is demonstrated by the fact that the share of defence expenditure in the GDP will rise somewhat next year. This year, the Chief Executive had announced in his Economic Revival Plan that a saving of Rs 7 billion was being made in the defence budget for diversion to the poverty alleviation program. This was generally welcomed by the people. But, unfortunately, this has not happened. The original budget allocation for defence was Rs 142 billion which should have been brought down to Rs 135 billion. But in the revised estimates an expenditure of over Rs 143 billion has been reported. Therefore, the savings have not materialised. On top of the larger expenditure base an increase of 11 per cent has been made in the allocation for defence. Overall, the government appears to have placed very little emphasis on containment of non-interest current expenditure in the budget.

Third, the fragility of the assumptions underlying the budget is demonstrated by the way it is proposed to finance the budget deficit. The goal of self-reliance seems to be very remote in the minds of the budget makers. Almost two thirds of the financing is to be external in character.

Over Rs 42 billion of program assistance in 2000-01 has been assumed when the IMF program has not yet been put into place. Therefore, if the external financing assumptions do not materialise or if there is a significant shortfall in the achievement of the tax revenue target then the budget could come under severe pressure. As in the past this could lead to an abandonment of part of the development program and thereby jeopardise prospects further of an early economic revival.

Altogether, it seems that the budget for 2000-01 is primarily a 'stabilisation' budget which proposes to achieve substantial fiscal deficit reduction. The strategy for achieving this is balanced with, more or less, equal emphasis on resource mobilisation and expenditure containment. However, the budget rests critically on three targets, viz., growth in tax revenues, reduction in interest payments and higher program financing from donors. If one or more of these targets begins to look elusive, then the budget will be in serious jeopardy and the government may be compelled to change its strategy midstream during the year.

WHAT IS THE TRUE FISCAL DEFICIT IN 1999-2000?

By
Dr. Hafiz A. Pasha
Zafar H. Ismail

The Budget Speech of the Finance Minister says that the revised estimate of the fiscal deficit for 1999-2000 is Rs 193 billion, equivalent to 6.1 per cent of the GDP. This exceeds the original deficit target for the year of Rs 117 billion by as much as Rs 76 billion. Last year, the fiscal deficit was also 6.1 per cent of the GDP. Therefore, the government has failed to achieve any significant fiscal adjustment this year. This is not yet all the bad news. It appears that the fiscal deficit for 1999-2000 may be even higher than reported in the Budget Speech on the basis of the revised estimates released by the government.

The basic problem with monitoring the trend in the magnitude of the fiscal deficit is that the statement, Budget at a Glance, brought out alongwith the Budget Speech does not give the figure of the budget deficit. Conceptually, the budget deficit is simply the difference between total revenues and total expenditure, with the former including both tax revenues and non-tax revenues and the latter including both current and development expenditure. If the total PSDP is charged to the federal government then the combined fiscal deficit is simply the sum of the overall deficit of the federal government minus the revenue surplus of the provincial governments. The latter corresponds to the self-financing of PSDP by provinces which is given in the Budget at a Glance.

However, it is important to remember that in estimating total expenditure only the interest component of debt servicing must be included. Debt repayment is not included in expenditure because it is used for reduction in the outstanding debt and, thereby, contributes to reducing liabilities. As such, repayment of foreign loans by the federal government, repayment of loans by provincial government to the federal government and net recovery from others (corporations, etc.) are excluded from expenditure.

Therefore, we have the formula for computing the consolidated fiscal deficit of the federal and provincial governments as follows:

Fiscal deficit = federal current expenditure + development expenditure (PSDP)
) net federal revenue receipts) self-financing of PSDP by provinces
) repayment of foreign debt) loan recovery from provinces + net lending to others

All the above magnitudes are available in the Budget at a Glance except three, viz, repayment of foreign debt, loan recovery from provinces and net lending. These have to be obtained from another budget publication, the Budget in Brief. It is strongly urged that at the least the government should give at the end of the Budget at a Glance the figure of the implied fiscal deficit of the federal and provincial governments combined. This will greatly improve the transparency in budgetary reporting.

Based on the above formula, the fiscal deficit for 1999-2000 is computed in Table 1.

TABLE 1
THE FISCAL DEFICIT IN 1999-2000

(Rs in Billion)

	Head	**1999-2000 (Revised Estimate)**
	Current Expenditure	565.4
plus	Development Expenditure	100.6
minus	Net Revenue Receipts	377.1
minus	Repayment of Foreign Loans	79.2
minus	Self Financing of PSDP by Provinces	6.8
minus	Repayment of Loans by Provinces	8.0
plus	Net Lending to Others	-12.9
	FISCAL DEFICIT	207.8
	GDP (mp)	3173.7
	FISCAL DEFICIT as % of GDP	6.5

Source: Budget-in-Brief, Ministry of Finance, Government of Pakistan

Lo and behold, we observe a major descrepancy in the budget deficit estimates. The fiscal deficit for 1999-2000 works out to Rs 207.8 billion and not Rs 193 billion as reported in the Budget Speech. This implies that the extent of underreporting of the budget deficit is to the tune of Rs 14.8 billion' and the budget deficit is not 6.1 per cent but 6.5 per cent of the GDP. At Rs 207.8 billion, the budget deficit in 1999-2000 is the largest deficit ever. It even exceeds the peak level of deficit attained in 1997-98 of Rs 205 billion and does not testify to good fiscal management by the government.

The Ministry of Finance is requested to clarify if the formula used above for calculating the fiscal deficit is correct or not. If it is, then according to government's own figures contained in the publication, Budget in Brief, the deficit works out to Rs 207.8 billion and not Rs 193 billion. The government has accused the previous government of 'fudging the figures' of the budget deficits in 1997-98 and 1998-99. At the minimum, this government should have done its arithmetic right in computing the fiscal deficit for 1999-2000.

' *We received clarification by phone on the 30th of June 2000 from the Finance Secretary, Government of Pakistan, that the four provinces have generated a revenue surplus of Rs 14.8 billion over and above the amount of Rs 6.8 billion used for self-financing of their PSDPs. In fact, the latter figure is higher than the budgeted figure of Rs 3.9 billion. It seems highly unlikely with transfers to provinces exceeding budget estimates by about Rs 4.2 billion the provinces could have built up cash balances of Rs 14.8 billion. We have asked Ministry of Finance to provide evidence that provinces have, in fact, built up such large cash balances of Rs 14.8 billion.*

BUDGETARY OUTCOME IN 1999-2000: FISCAL DEFICIT EXCEEDS TARGET BY RS 95 BILLION

By
Imran Ashraf Toor

The Finance Minister in his Budget Speech indicated that there are some developments in the economy which are not satisfactory. Number one in his list of unsatisfactory developments is the continuing large fiscal deficits. As admitted by the Finance Minister, the target fiscal deficit for 1999-2000 was Rs 117 billion, whereas the actual deficit is likely to be Rs 193 billion. In fact, calculations of the budget deficit at SPDC reveal that the performance has been even worse. According to numbers contained in the *Budget-in-Brief*, the budgeted deficit for 1999-2000 was Rs 113 billion whereas the actual deficit is likely to be close to Rs 208 billion (see previous note), an excess of as much as Rs 95 billion. As a percentage of the GDP, 1999-2000 has witnessed the largest divergence of the actual fiscal deficit from the target during the decade of the 90s.

An excess deficit of as much as Rs 95 billion (or 3 per cent of the GDP) does not testify to good fiscal management by the government in 1999-2000. However, the Finance Minister places the responsibility for the higher deficit squarely on the shoulders of the previous government. He says in the Budget Speech:

> *"... a number of significant items of expenditure were not properly accounted for by the makers of the last budget. Obligatory expenditures, such as debt servicing, were not budgeted. Similarly, many of the measures, on which revenue estimates were based, were not taken in time, such as regular adjustment in petroleum prices...."*

The objective of this article is to examine the validity of the explanation that the entire failure in achieving the deficit target was due to improper budgeting and policy inaction (between July 1 and October 12 1999) on the part of the previous government or can it also be attributed to other developments after October 12 1999 which reflect more on the performance of the present government?

The nature of divergence of the revised estimates from budget estimates for 1999-2000 is given in summary form in Table 1. This enables an understanding of why the budget deficit is substantially larger. It appears that total expenditure (net of foreign debt repayment) was understated by Rs 29 billion, net revenues of the federal government were overstated by Rs 45.8 billion, net lending to others (local bodies, financial institutions, WAPDA and non-financial institutions) etc., was overstated by Rs 23.2 billion, while self-financing of PSDP by provinces showed an improvement of Rs 2.9 billion. The result was an excess deficit of Rs 95.1 billion.

TABLE 1
DIVERGENCE OF REVISED ESTIMATE FROM BUDGET ESTIMATE OF THE FISCAL DEFICIT IN 1999-2000

(Rs in Billion)

	1999-2000		Difference
	Budget Estimate	**Revised Estimate**	
A. Current Expenditure	525.9	565.4	39.5
B. Development Expenditure	116.3	100.6	-15.7
C. Net Revenue Receipts	422.9	377.1	-45.8
D. Repayment of Foreign Loans	84.4	79.2	-5.2
E. Self-Financing of PSDP by Provinces	3.9	6.8	2.9
F. Recovery of Loans from Provinces	8	8	0
G. Net Lending to Others	10.3	-12.9	-23.2
FISCAL DEFICIT	112.7	207.8	95.1

Why was current expenditure higher by as much as Rs 39.5 billion? Table 2 reveals that this is primarily due to two factors, underbudgeting of debt servicing and subsidies respectively. The Finance Minister is right in highlighting the underbudgeting of some

TABLE 2
DIVERGENCE IN CURRENT EXPENDITURE

(Rs in Billion)

	1999-2000		Difference
	Budget Estimate	**Revised Estimate**	
Current Expenditure	525.9	565.4	39.5
Debt Servicing	287.4	313.7	26.3
Interest on Domestic Debt	160.6	183.9	23.3
Foreign Loan Repayments	84.4	79.2	-5.2
Defence	142	143.3	1.3
Running of Civil Government	48.3	47.9	-0.4
Grants	38	41	3
Subsidies	2.4	14.4	12
Unallocable	7.7	5.1	-2.6

obligatory expenditures, such as debt servicing. The revelation that the previous government engaged in 'fudging of figures' during 1997-98 and 1998-99 so as to understate the fiscal deficit did have the implication that with an apparently lower base, some expenditures were likely to be underprojected in 1999-2000. As demonstrated in a later note in this report on 'fudging of figures' much of the understatement of expenditure in 1998-99 was in debt servicing and defence expenditure. Therefore, the fact that debt servicing exceeded the budget estimate by Rs 26.3 billion is clearly due to under provisioning by the previous government in the process of budget making for 1999-2000.

But why were subsidies higher by Rs 12 billion in 1999-2000? The original estimate was only Rs 2.4 billion whereas the actual expenditure under this head increased to Rs 14.4 billion by the end of the year. Much of this is due to additional subventions to WAPDA and KESC in lieu of the deterioration of the financial position of these entities due partly to levy of GST on electricity and a corresponding downward adjustment in the additional surcharge of these utilities on particular categories of consumers. In the process of broad-basing of GST it was this governments' decision to protect agricultural, domestic and other consumers from a consequential increase in tariffs. While there be strong justification for such a decision, the higher subsidy bill is clearly the responsibility of this government.

Turning to the shortfall in net revenue receipts of Rs 45.8 billion, Table 3 shows that this is largely due to lower collections from surcharges of Rs 26.6 billion and a lower yield from non-tax revenues of Rs 10.6 billion. Here again, one is tempted to conclude that the Finance Minister is right when he says that the revenue shortfall in petroleum

TABLE 3
DIVERGENCE IN NET REVENUE RECEIPTS

(Rs in Billion)

Head	1999-2000		Difference
	Budget Estimate	Revised Estimate	
Gross Revenue Receipts	560.9	519.4	-41.5
Tax Revenues	356	351.6	-4.4
Surcharges	63.3	36.7	-26.6
Non-Tax Revenues	141.7	131.1	-10.6
Less Transfers to Provinces	138	142.3	4.3
Net Revenue Receipts	422.9	377.1	-45.8

surcharge is due primarily to the inability of the previous government to make regular adjustments in petroleum prices between July 1 and October 12 1999. The Nawaz Sharif government did falter in adjusting petroleum prices as per the formula agreed with the IMF in the face of rising prices and this was one the key factors why Pakistan became non-compliant in terms of implementing the ESAF program conditionalities and no further tranches were released under this program after May 1999.

However, the story about the fall in revenue from petroleum surcharges is a more complicated one than implied in the budget speech. Part of the fall, especially in the first few months of the year, is due, no doubt, to lack of price adjustment, but since December 99 the present government has been adherely to the quarterly adjustment formula strictly and it must get credit for this discipline. The real reason for the large fall in revenue from the petroleum development surcharge in 1999-2000 is the partial conversion of this surcharge to a GST on petroleum products. Although, estimates for the year are not yet available, it appears that over Rs 15 billion of revenue have been transferred from the head of petroleum surcharge to GST. Therefore, out of the total shortfall of Rs 26.6 billion, the previous government can be held responsible, at best, for a loss of Rs 11.6 billion due to lack of price adjustments in the first four months and twelve days of 1999-2000.

Why was there a shortfall of Rs 10.6 billion in non-tax revenues? Two factors appear to be responsible for this underachievement of target. The first is a shortfall in SBP profits of Rs 5 billion. This is probably due to exchange losses incurred in larger than anticipated purchases (at a premium) by the central bank from the kerb market and lower returns on T-bills. The second major fall of over Rs 8 billion is in 'other' miscellaneous receipts. Here the responsibility appears to fall on the shoulders of the previous government which wrongly classified the payment of F-16 money of Rs 7.3 billion as a receipt and not as a financing item, and which was not received in 1999-2000.

Finally, we have the larger divergence in net lending to others. The government was expected to make a net recovery of Rs 10.3 billion, instead there was a net outflow of 12.9 billion, leading to an overall difference from budget estimates of Rs 23.2 billion. What explains this large

descrepancy? No proper explanation for this is given in the budget documents. However, bulk of the divergence is probably due to adjustments and flows with respect to WAPDA including possibly a debt-equity swap.

Altogether, from the above analysis, it appears that the previous government can be held responsible for the following factors which have contributed to the substantially larger fiscal deficit in 1999-200:

	(Rs in Billion)
• underprovision for debt servicing in the budget	26.3
• lack of timely adjustment in petroleum prices	11.6
• misclassification of F-16 money and its non-receipt	7.3
TOTAL	**45.2**

The actual fiscal deficit was higher than budget by Rs 95.1 billion. Therefore, after netting out the above figure, an excess deficit of Rs 49.9 billion is attributable to other events during 1999-2000 and actions taken by the present government. Therefore, in contrast to the explanation offered by the Finance Minister, the present government must accept responsibility for a larger part of the excess fiscal deficit in 1999-2000. Clearly, there is scope for improvement in the quality of fiscal management. We hope that with better management of public finances, the government will not exceed significantly the target deficit of Rs 162 billion (or 4.6 per cent of the GDP) which it has set for itself for the next fiscal year.

THE 'FUDGING OF FIGURES'

By
Zafar H. Ismail

An admission by the military government that the previous government grossly understated the budget deficits for the years, 1997-98 and 1998-99, to the IMF has had major implications for the country's credibility with donor agencies and negatively impacted on the relationship with the Fund. Pakistan has had to make an advance repayment of $ 55 million to the IMF as a consequence of this revelation. Two interpretations have been given for the understatement of the deficit figures. The Chief Executive and the Finance Minister are inclined to view this as conscious 'fudging of figures' while the Governor of the SBP has indicated that this is more in the nature of an accounting systems failure resulting from a lack of timely and well-structured reconciliation procedures.

A fund technical assistance mission came to Pakistan in January this year to make recommendations for improving fiscal reporting and budget management. Although the report submitted has not been made public, apparently the report has highlighted five items which have contributed most to the disparities: non-bank financing through National Savings Schemes (NSS), other non-bank financing, foreign financing, interest expenditure and defence expenditure. Therefore, the higher fiscal deficits are due primarily to larger than reported interest payments and defence expenditure which have been largely financed by higher than reported non-bank borrowing and external borrowing.

The recent release of the *Economic Survey* for 1999-2000 enables on analysis of exactly what happened in 1997-98 and 1998-99. This survey has published figures for the first time of the actuals for the two years of the federal government's overall budgetary position. By comparing these actuals with the revised estimates published in earlier surveys it is possible to get quantitative estimates of descrepancies in different heads. Results of this analysis are given below.

1998-99

Table 1 gives the extent and pattern of the so-called 'fudging of figures' in 1998-99. The deficit originally reported in June 1999 was Rs 101.4 billion (equivalent to 3.4 per cent of the GDP) at the time of presentation of the budget for 1999-2000. The deficit figure reported now is Rs 176 billion (equivalent to 6.1 per cent of the GDP), an increase of Rs 74.6 billion in relation to the original figure.

TABLE 1
EXTENT AND PATTERN OF 'FUDGING OF FIGURES' IN 1998-99

	Amount (Rs in Million)	%
• **ABOVE THE LINE**		
Overstatement of Revenues	36,548	49.0
Tax Revenues	-5,192	-7.0
Non-Tax Revenues	41,740	56.0
Understatement of Expenditure	38,074	51.0
Current Expenditure:	24,856	33.3
(Interest)	(14,960)	(20.0)
(Defence)	(15,471)	(20.7)
(Others)	(-5,575)	(-7.4)
Development Expenditure	13,218	17.7
Understatement of Fiscal Deficit	74,622	100.0
• **BELOW THE LINE**		
External Borrowing	88,733	118.9
Non-Bank Borrowing	-1,372	-1.8
Bank Borrowing	-12,739	-17.1

Source: PES, 1999-2000
Statistical Supplement, PES, 1998-99

The question is how much of the increased deficit is due to overstatement of revenues and how much because of understatement of expenditure. Table 1 reveals that the contribution of the two factors is about equal. The overstatement of revenues is Rs 36.5 billion while the overstatement of expenditure is Rs 38.1 billion.

Much of the overstatement of revenues is in non-tax revenues. In fact, tax revenues appear to have been understated by Rs 5.2 billion. The misreporting of non-tax revenues appears to be due not to conscious 'fudging' but due to a dispute on the classification of certain receipts. Government of Pakistan originally reported the receipts of an installment of F-16 money (Rs 16.4 billion) and the value of the Saudi Oil facility (Rs 12.6 billion) for 1998-99 as 'miscellaneous receipts' above the line. The argument put forward was that since the F-16 money was a refund of the amount paid for the aircraft (and, therefore, originally treated as expenditure), the refund should also be shown above the line as a receipt (like the original payment).

As far as the Saudi Oil Facility is concerned, its treatment depends upon whether it is a straight grant or essentially represents deferred payment (type of suppliers' credit) of oil imports. If it is a grant then the Government of Pakistan was probably justified in treating it as a receipt because it does not create any downstream liabilities as borrowings do, whereas if it is in the form of a deferred payment then it is more legitimately a financing item as asserted by the IMF. Since the terms of the Saudi Oil Facility are not publicly known it is not possible to comment on this matter.

As far as the divergence in expenditure is concerned, interest payments are higher by about Rs 15 billion and defence expenditure by Rs 15.4 billion, as identified by the IMF mission report referred to earlier. But the new revelation is that development expenditure was also higher by as much as Rs 13.2 billion. The accounting system problem arises especially in the context of interest payments, particularly on national savings schemes. These are made by the multitude of Central Directorate of National Saving offices, banks and post offices and it is possible that these cannot be reconciled on a timely basis (before the end of the financial year) by AGPR.

It is unlikely, however, that defence and development expenditure can be underreported due to accounting problems, because releases under these heads are highly centralised. Apparently, there was a year -end spurt in defence expenditure in the month of June 1999 which could not be fully reflected in the revised estimates at the time of presentation of budget in early June. However, it is difficult to accept that the government did not know that development expenditure was higher than the number revealed.

Altogether, we have a mixed explanation for what happened in 1998-99. The overstatement of revenues is largely the reflection of a problem of classification and probably not deliberate 'fudging of figures'. On the expenditure side, part of the problem of understatement of expenditure, especially of interest payments on NSS, perhaps largely reflects an accounting systems problem, but there exists the possibility that both defence and development expenditure were deliberately underreported.

On the financing side, contrary to what the IMF report says, non-bank borrowing has not been substantially larger. In fact, it is lower than the original estimate by Rs 1.8 billion. The question that arises is that if the government was able to get a good estimate of the net inflow into NSS from the vast network of CDNS and bank branches and post offices, then why was such a large mistake made in picking up interest payments?

It appears that the higher deficit in 1998-99 was largely financed by higher external borrowing of as much as Rs 88.7 billion, with bank borrowing being lower than originally estimated by Rs 12.7 billion. How could such a large descrepancy arise when external inflows are very closely monitored by the Ministry of Finance and the SBP? This remains a mystery and does not reflect too well on the reporting system of both these entities.

1997-98

The total understatement of the fiscal deficit in 1997-98 is Rs 51 billion as shown in Table 2. The deficit originally reported was Rs 153.6 billion (equivalent to 5.6 per cent of the GDP) which has increased to Rs 204.6 billion (equivalent to 7.7 per cent of the GDP). Most of it is due

to understatement of expenditure by Rs 43.8 million, while overstatement of revenues has contributed Rs 7.2 billion to the higher deficit.

TABLE 2
EXTENT AND PATTERN OF 'FUDGING OF FIGURES' IN 1997-98

	Amount (Rs in Million)	%
• **ABOVE THE LINE**		
Overstatement of Revenues	7,167	14.1
Tax Revenues	6,945	13.6
Non-Tax Revenues	222	0.5
Understatement of Expenditure	43,830	85.9
Current Expenditure:	33,624	65.9
(Interest)	(10,673)	(20.9)
(Defence)	(4,811)	(9.4)
(Others)	(18,140)	(35.6)
Development Expenditure	10,206	20.0
Understatement of Fiscal Deficit	50,997	100.0
• **BELOW THE LINE**		
External Borrowing	12,148	23.8
Non-Bank Borrowing	39,286	77.0
Bank Borrowing	-437	-0.8

Source: *PES, 1999-2000*
Statistical Supplement, PES, 1997-98

Within expenditure, the major heads which were understated include expenditure on civil administration, services, subsidies, etc (by Rs 18.1 billion), interest payments (by Rs 10.7 billion) and development expenditure (by Rs 10.2 billion). In revenues, most of the overreporting was of tax revenues.

On the financing side, most of the incremental deficit of Rs 51 billion was financed by non-bank borrowing (additional borrowing of Rs 39.3 billion). External borrowing was also higher by Rs 12.1 billion while bank borrowing was lower than the original estimate by 0.4 billion.

Overall, the explanations offered uptil now by the IMF mission report originally and subsequently by the government for the 'fudging of figures' do not depict fully what happened in 1997-98 and 1998-99. The inflow into NSS was not larger as claimed but external borrowing has turned out to be substantially higher in 1998-99. Also, in 1998-99, the higher reporting of revenues in 1998-99 appears to be more a reflection of a classification problem than deliberate fudging. In 1997-98 much of the expenditure underreporting was not in interest payments and defence expenditure as indicated by the IMF but in 'other' expenditure (civil administration, services, subsidies grants, etc.) and development expenditure.

Therefore, the diagnosis of what happened in these two years is not entirely correct. The general feeling one gets is that the present government yielded too readily to the IMF estimates without proper investigation and diagnosis of the problems with budgeting because it reflected poorly on the previous government, although it has affected our credibility internationally. Apparently, a commitment has already been made by the government to the IMF to reconcile the deficit figures for years prior to 1997-98. We hope that the results of these investigations will be made public soon.

THE FEASIBILITY OF TAX REVENUE TARGETS

By
Dr. Hafiz A. Pasha
Fauzia Mukarram

Perhaps the most crucial figure in the Budget for 2000-01 is the target set for tax revenues to be collected by the CBR. From Rs 351.6 billion this year, tax revenues are expected to increase to Rs 435.7 billion. This implies an absolute increase of over Rs 84 billion and a growth approaching 24 per cent. Such a large absolute increase has never been achieved before and what makes the task even more daunting is that there are no major taxation proposals in the budget involving significant enhancement in tax rates or withdrawal of exemptions. If anything, a net tax relief approaching Rs 3 billion has been provided in the budget. How then is this ambitious target of growth in CBR tax revenues going to be achieved?

The objective of this article is to assess the feasibility of the tax revenue targets for 2000-01. We first analyze the historical performance of CBR revenues during the decade of the 90s and identify conditions under which relatively high growth rates of revenue were observed in particular years. This is followed by an analysis of the performance during the current year. We then describe the factors identified by the government for projecting fast revenue growth next year and assess their validity. Based on this we formulate a judgement about the likelihood of targets being achieved next year.

Historical Performance

There have been large fluctuations year-to-year in tax revenues. The highest growth rate during the decade of the 90s was witnessed in 1994-95 when it exceeded 31 per cent as shown in table 1. Other relatively good years were 1991-92 and 1995-96 with growth rates of 26 per cent and 18 per cent respectively. A number of factors distinguish these years. First, in each of these years the growth rate of the GDP was high, in excess of 5 per cent, as compared to the average for the decade of about 4.5 per cent. Second, in all three years much of the buoyancy in tax revenues is attributable to fast growth in direct taxes. In 1991-92 direct taxes showed a growth of as high as 45 per cent while in 1994-95 and 1995-96 the growth rate of direct taxes was 42 per cent and 27 per cent respectively.

TABLE 1
BUOYANCY RATIO OF CBR TAXES

Year	Tax Revenues	Nominal GDP	Buoyancy Coefficient
1990-91	6.0	19.2	0.31
1991-92	26.5	18.7	1.42
1992-93	9.6	10.8	0.89
1993-94	12.6	17.3	0.73
1994-95	31.3	19.6	1.60
1995-96	18.3	13.8	1.33
1996-97	5.2	14.7	0.35
1997-98	4.0	9.0	0.44
1998-99	5.0	8.8	0.57
1999-2000	14.0	8.9	1.57
Average for 90s	13.2	14.0	0.94
2000-01(budget)	**23.1**	**9.7**	**2.38**

As opposed to this, years when revenues have shown little growth have usually been years when the economy grew slowly. The best demonstration of this is the period, 1996-97 to 1998-99, when the GDP growth rate fell on average to about 3 per cent only and revenue growth was restricted to only about 5 per cent. The general conclusion is that for tax revenues to grow rapidly one of the essential pre-conditions is that the economy must be experiencing fast growth. It is the rapid expansion in the tax base which primarily fuels fast revenue growth in the economy. Also, it appears that the most buoyant source of revenue is direct taxes which respond most to higher growth in the economy.

An analysis of the historical performance of CBR revenues reveals that in at least two years, 1991-92 and 1994-95, revenues have shown faster growth than the target (of 24 per cent) set for next year. Therefore, achievement of the target growth rate is not unprecedented. But it is important to note that the nominal GDP growth rate in 1991-92 and 1994-95 was as high as 19 per cent and 20 per cent respectively and the economy was expanding rapidly with relatively high rates of inflation. For 2000-01, however, the Annual Plan targets are for a 5 per cent growth rate of the real GDP and a rate of inflation of 4.5 per cent, implying a nominal GDP increase of less than 10 per cent. Therefore, the task assigned to CBR is potentially much tougher next year, because it is expected to achieve fast revenue growth on the back of relatively slow nominal GDP growth. In fact, the buoyancy coefficient (ratio of revenue growth to nominal GDP growth) at almost 2.4 in 2000-01 has never been attained previously.

Performance in 1999-2000

CBR revenues are expected to close the year with growth of about 14% as shown in table 2. This compares favorably with the previous three years. But contrary to the growth patterns in previous years of high revenue growth, the leading tax this year is the general sales tax and not direct taxes. The former is expected to show extraordinary growth of almost 67 per cent while the latter has actually shown a minor fall. The buoyancy in GST is attributable to major reforms in the tax during the year involving substantial broad-basing to petroleum products, gas and electricity and the full year effect of the enhancement in the standard rate from 12.5 per cent to 15 per cent. But what is worrying is the lack of buoyancy in direct taxes which have remained flat at Rs 110 billion. This is probably a reflection of the recession in the large-scale manufacturing and banking and a resulting decline in corporate profitability.

TABLE 2

ANALYSIS OF GROWTH IN FEDERAL TAX RECEIPTS

(Rs. in Billion)

Heads	(1996-97)	(1997-98)	(1998-99)	(1999-00)	(2000-01)
Tax Revenues and Surcharges	309.5	336.5	386.9	388.3	473.6
% Growth		(8.7)	(15.0)	(0.4)	(22.0)
Tax revenues	282.2	293.6	308.5	351.6	435.7
% Growth		(4.0)	(5.1)	(14.0)	(23.9)
Income & wealth Tax	85.1	103.2	110.4	109.8	137.5
% Growth		(21.3)	(7.0)	(-0.5)	(25.2)
Custom Duties	86.1	74.5	65.3	64.8	72.9
% Growth		(-13.5)	(-12.4)	(-0.8)	(12.5)
Federal Excise	55.3	62.0	60.9	57.0	52.6
% Growth		(12.1)	(-1.8)	(-6.4)	(-7.7)
Sales Tax	55.7	53.9	71.9	120.0	172.6
% Growth		(-3.2)	(33.4)	(66.9)	(43.8)
Surcharges	27.3	42.9	78.3	36.7	38.0
% Growth		(57.1)	(82.5)	(-53.1)	(3.5)
Natural Gas	4.8	6.4	11.9	10.2	15.0
% Growth		(32.2)	(85.9)	(-14.3)	(47.1)
Petroleum	22.5	36.5	66.4	26.5	23.0
% Growth		(162.4)	(81.9)	(-60.1)	(-13.2)

Revenue Targets for 2000-01

As we move to the next fiscal year, the revenue target for CBR has been enhanced by 24 per cent as compared to the actual increase of 14 per cent this year. The substantial improvement is to be

achieved with only a minor increase in the growth rate of the economy from 4.5 per cent to 5 per cent and a rise in the rate of inflation from about 3.5 per cent to 4.5 per cent. Apparently, this is predicated on a fundamental change in the resource mobilization strategy. No longer is the government relying on enhancements in tax rates to raise more revenues. Instead, it is focusing more on effective broad-basing of the tax system and through improvements in tax administration and stronger enforcement of tax laws it proposes to make major inroads into tax evasion in the economy.

The essential elements of the new strategy appear to be well founded. In previous years, heavy taxation proposals have been announced in budgets, sometimes aggregating to over Rs 40 billion of additional taxation, but in the absence of proper enforcement end-year results have generally been disappointing. In addition, the enhancement in tax rates has had deleterious consequences on the economy and jeopardized the process of revival. The government has sensibly avoided this path.

What are the cornerstones of the strategy for broad-basing the tax system and curbing tax evasion? First, the government has made a major foray into a hitherto undertaxed sector, wholesale and retail trade, by levy of the GST on this sector initially on the basis of a 2 per cent tax on turnover above the exemption limit of turnover of Rs 1 million. Second, determination of turnover and incomes generally is being pursued through a tax survey for documentation of the economy which is being administered on all businesses and properties (owners or tenants) in 13 major cities of the country. This is expected to lead to the identification of a large number of new income taxpayers, detect underdeclaration by existing taxpayers and also establish the benchmark turnover for the GST on retail trade. Third, the government is proceeding with major revamping of CBR with the objective of eliminating corruption and producing a more taxpayer-friendly tax system. Ideally, this task of reorganizing CBR and improving its public perceptions should have been completed before launching the documentation drive.

Given the new strategy, the targets for individual taxes have been justified on the following grounds:

Direct Taxes

Direct taxes are expected to increase from about Rs110 billion this year to Rs 137.5 billion next year, showing a growth of over 25 per cent. This high growth is to be achieved following a year of stagnation of revenues. If the once-and-for-all effect of the Tax Amnesty Scheme on revenues this year is excluded, the expected growth rate is even higher.

On the assumption that the two key sectors, large-scale manufacturing and banking, stage a recovery next year and that withholding/presumptive taxes from suppliers, importers and contractors show some buoyancy, the normal growth in direct taxes could yield an extra Rs 11 billion of revenue, out of the total increase expected in revenues of over Rs 26 billion. The remaining Rs 15 billion or so appears to be the expectation of the additional revenue yield from the tax survey.

General Sales Tax

General sales tax is projected to show continuing buoyancy next year and its revenue contribution is projected to increase from Rs 120 billion to Rs 172.6 billion, an increase of almost Rs 53 billion and a growth rate of almost 44 per cent. Here again, under favorable assumptions of normal growth the increase next year is about Rs 15 billion. In addition, there is the full-year effect of the broad-basing initiatives taken mid-stream in 1999-2000 which is estimated to yield another Rs 15 billion. The switchover from excise duties to GST on services will contribute Rs 8 billion. These three factors – normal growth, yield from previous reforms and introduction of GST on services – explain Rs 38 billion of the revenue increase targeted of almost Rs 53 billion. The remainder, almost Rs 15 billion, is the expected yield from the GST on retail trade, which is being implemented by establishment of benchmark turnover of individual retail outlets through the tax survey.

Revenue targets for customs duties and excise duties essentially reflect normal growth expectations. In the latter case, revenues are expected to register a drop of about Rs 5 billion next year due to the withdrawal of this tax from services and its substitution by GST.

Analysis of the factors behind the expected growth next year of CBR reveals the importance of two sets of assumptions. First, that normal growth in revenues will be realized. This will require in particular that the primary tax bases in the economy, viz., large-scale manufacturing and imports, show buoyancy and that a GDP growth rate of 5 per cent or more is achieved next year. Second, that the tax survey will be successful in documenting the incomes and transactions of the majority of actual and potential tax payers and will in the short run yield an additional Rs 15 billion of GST revenue and Rs 15 billion of direct tax revenue, a total of Rs 30 billion.

At this stage, it would be useful to assess the potential of the GST on retail trade as it is currently structured. This is a large sector which is expected to contribute almost Rs 500 billion to the national value added next year. With a 15 per cent margin, this implies that the turnover exceeds Rs 3300 billion. But not all this turnover is likely to be included in the tax net for the following reasons:

(i) The 13- city tax survey will probably document only about 50 per cent of this turnover.

(ii) Retail outlets with turnover of less than Rs 1 million will remain exempt. This could exclude up to 40 per cent of the turnover.

(iii) Outlets with turnover in excess of Rs 1 million will have almost 50 per cent of turnover in foodstuffs and other goods which are exempt from GST.

Therefore, on the basis of these erosions of the tax base the likely tax base of turnover for the GST on retail trade is about Rs 500 billion. The 2 per cent tax can yield about Rs 10 billion with full exploitation of this tax base. Therefore, the assumed revenue from the GST on retail trade of Rs15 billion is on the high side.

As far as the direct tax yield from the tax survey is concerned it needs to be remembered that bulk of the revenues come from the corporate sector which is already documented and assessed for tax purposes. The 0.7 million self-employed taxpayers (including traders) currently contribute Rs 3.5 billion while the 0.6 million salaried tax payers pay Rs 7 billion as income tax.

In view of deductions at source, the likelihood of significant tax evasion in the latter category is low. There is probably substantial tax evasion in the former category but the tax yield currently is very small. The expected direct tax yield of Rs 15 billion from traders, other self employed and small businesses as a result of the tax survey also appears to be optimistic.

Altogether, the expectation of short-run yield of Rs 30 billion from the tax survey is unrealistic. Of course, estimates of an yield of upto Rs 100 billion have been mentioned but serious research reveals that the potential is much more limited and the government ought initially to have been cautious in its expectation given the nature of the process which will ultimately translate into higher revenues.

Therefore, the expectation of an increase of Rs 84 billion in CBR revenues next year is based on optimistic assumptions about normal growth and the yield from the tax survey. If recent experience is any guide, targets for CBR revenue have been scaled down successively during the fiscal year. The margin of error in projection of revenues is potentially large this year. We hope that suitable contingency plans have been put in place in the event CBR revenues do not show the expected buoyancy next year.

ANALYSIS OF BUDGETARY PROPOSALS

By
Muhammad Sabir

The first federal budget of present military government unveiled by the Finance Minister appears to be a soft budget with a new agenda of tax reforms. This agenda focuses on elimination of the multiplicity of taxes, reduction in tax rates, broadening of tax bases, and last but not the least increased efficiency and honesty in tax administration. To prove the above claims, the budget contains Tax Reforms that have net negative impact of Rs. 2.8 billion (for details see table 1), a net relief for the first time since 1991-92. A number of questions arise with regard to budget. Are the taxation reforms structural in character, which will broaden the tax base and make taxes more buoyant? Are they easy to administer and will increase tax compliance, reduce leakage and thereby help in attaining revenue targets? Finally, which segments of the society will bear the burden of the reforms and which will enjoy the fruits of relief measures? Before we answer these questions it is better to look briefly on the key tax reforms.

Overview of the Budgetary Proposals

Contrary to the previous practices, current tax reforms portray a new approach that contains implicit resource mobilization strategy and explicit relief measures. In the case of the former the focus of all hopes of higher revenues is on the on-going tax survey. It will effect the overall revenues in three ways, increase in number of taxpayers (broad-basing of the income tax), higher income tax revenues from the existing taxpayers and finally increase in sales tax revenues. Other than this the remaining resource mobilization strategies are based on marginal revisions of the tax rates on the already taxed income and switching from excise duty to GST on services. Another important proposal that will have a positive impact on the revenues is "Presidential Tax Law Amendment Ordinance, 2000". This amendment came before the budget and primarily addressed the sales tax law. It envisages the levy of a turnover tax at the rate of 2 per cent on retailers having annual turnover exceeding Rs. 1 million till 30 June 2001. According to estimates by CBR this move will fetch an additional amount of Rs 15 billion. In our analysis we treat this amendment as a budgetary proposal and a key part of the ongoing tax reforms.

Contrary to the resource mobilization strategy, explicit relief measures are based on the reduction in income tax rates for the salaried class from 5 per cent to 80 per cent depending upon the level of salaries, abolition of the wealth tax and some relief measures for information technology and charitable institutions.

Historical Performance in Resource Mobilization

This budget is different in that does not propose major enhancements in tax rates and relies more on broad-basing of the tax system and improvements in tax administration. This is probably the right strategy since past experience is that the yield from taxation proposals has been lower than anticipated.

Table 1 highlights the performance of various governments in terms of their achievement of budgetary revenue targets during the last decade. Without exception every year there has been a shortfall, on the average of about 10 per cent. In the years 1994-95 and 1996-97 the largest quantum of taxation proposals were announced and it is in these years that relatively large shortfalls in revenues resulted. As opposed to this the short falls in recent years can be attributed more to slower growth in the economy than anticipated. In 2000-01, realisation of the revenue target also appears to hinge on buoyancy in the economy, especially of the primary tax bases like large-scale manufacturing value added and dutiable imports.

TABLE 1
THE FAILURE IN RESOURCE MOBILIZATION

(Rs. In Billion)

	Budget Estimates without Taxation Proposals (I)	Expected Revenues from Taxation Proposals (II)	Budget Estimates Including Revenues from Taxation Proposals (III) = (I) + (II)	Actual (IV)	Shortfall (III) -(IV)	Shortfall as % of the Budget Estimates
1991-92	136.5	16.1	152.7	142.0	10.7	7.5
1992-93	160.5	16.0	176.6	153.2	23.4	13.3
1993-94	176.6	14.0*	190.7	172.6	18.1	9.5
1994-95	214.4	45.5	259.9	226.6	33.3	12.8
1995-96	259.3	11.5	270.8	268.0	2.8	1.0
1996-97	296.4	39.9	336.3	282.1	54.2	16.1
1997-98	317.8	6.2	324.0	293.6	30.4	9.4
1998-99	338.2	16.4	354.6	308.0	46.6	13.1
1999-2000	356.0	17.9	373.9	351.6	22.3	6.0

Impact of Proposals on the Structure of Taxes

Pakistan's taxation structure has experienced various changes in the last decade, which are the outcome of reforms pursued by different governments. These reforms have primarily focused on increasing reliance on direct taxes as compared to indirect taxes, which have distortionary impact on overall economy as well as an adverse effect on the poorer segments of society. According to these efforts the share of direct taxes, which was only 19.1 per cent in 1990-91 has reached 28.3 per cent according to the revised estimates of 1999-2000.

TABLE 2

THE TAXATION STRUCTURE OF PAKISTAN

		1990-91		1999-2000		2000-01*	
		Revenues (Rs. Billion)	Share (%)	Revenues (Rs. Billion)	Share (%)	Revenues (Rs. Billion)	Share (%)
A.	***CBR Tax Revenue***	**101.5**	**89.2**	**351.6**	**90.6**	**432.9**	**91.9**
	Direct Taxes	19.1	16.8	109.8	28.3	135.7	28.8
	Indirect Taxes	82.4	72.4	241.8	62.3	297.3	63.1
	Custom Duties	50.5	44.4	64.8	16.7	71.4	11.1
	General Sales	6.9	6.1	120.0	30.9	173.3	36.8
	Excise Duties	25.0	22.0	57.0	14.7	52.6	15.2
B.	***Surcharges***	**12.3**	**10.8**	**36.7**	**9.4**	**38.0**	**8.1**
C.	**Total Tax Revenues** (C = A + B)	**113.8**	**100.0**	**388.3**	**100.0**	**470.9**	**100.0**

*including the amount of proposals

Within indirect taxes there have also been fundamental changes in the structure. The share of customs duties has fallen from 44.4 per cent to 16.7 per cent while the share of sales tax has increased dramatically from 6.1 to 30.9 per cent, indicating that much of the reform effort has been concentrated on developing this tax. The federal budget essentially continues on the same path, and the share of direct taxes and sales tax will increase further next year

Revenue Implications of the Tax Reforms

We have already stated that the government's resource mobilization strategy is largely based on the successful completion of the on-going tax survey and the imposition of GST on retail trade. If the target of collection from the latter is achieved of Rs 15 billion then the total revenue implications of the proposal contained in the Budget is about Rs 12 billion, the loss of Rs 3 billion arising due to the reliefs provided. Within reliefs the most significant are, first, the abolition of the wealth tax in 2001-02 and in the interim period an enhancement of the exemption

limit to Rs 2.5 million and, second, the reduction in personal income tax rates. The former will cost the exchequer Rs 3.7 billion and the latter, Rs 1.6 billion.

The three taxation proposals besides the GST on retail trade which will fetch significant additional revenue include, first, the levy of the 5 per cent surcharge on corporate tax which will yield Rs.1billion, second, the increase in the presumptive income tax on exporters which will fetch an extra Rs 1 billion and, third, the extra 1 percentage point presumptive tax on importers with revenue potential of Rs 2 billion.

TABLE 3
IMPACT OF TAX REFORMS
[Positive (+) / Negative (-)]

Proposals	Revenues (Rs in Billion)	Nature of Buoyancy	Redistributive Impact	Reduction in Distortion	Ease in Tax Administration
Direct Taxes	**-1.835**				
Withdrawal of Wealth Tax	-3.700	+	)	)	)
Increase in Presumptive Tax on import from 5% to 6%	2.000	)	)	)	)
Relief to Salaried Groups	-1.600	+	+	+	+
5% Surcharge on IT of Companies	1.000	+	)	)	)
0.25% Increase in Presumptive Income Tax on Exports	1.000	+	)	)	
Relief to Banks on Accrual	-0.700	+	)	+	+
Uniform 3% Tax on Import Stage of Edible Oil	0.240	)	)	+	)
Withdrawal of Presumptive Tax on Shipping	0.050	+	)	)	)
Relief to Charitable Institutions	-0.005	)	+	+	+
Withdrawal of 2% withholding Tax on Building Plans	-0.045	+	+	+	)
Reduction in Rate of Additonal Tax from 2% to 1.5%	-0.075	+	)	+	+
Tax Survey Implications	+	+	)	+	)
Self Assessment Scheme	+		)	+	+
Tax Amnesty Scheme			)	+	+
Indirect Taxes	14.082		)	+	+
2% turnover tax on retailers	15.000	+	)	+	)
Reduction in Custom Duties	-1.600	)	)	+	+
Net Impact of Relief measures on GST	0.466	+	+	+	+
Switching over from CED to GST on Services	0.216	+	)	+	)
Overall Net Effect	12.247				

Incidence of the Tax Reforms

One of the fundamental objectives of fiscal policy is to redistribute income between different segments of the society and thereby reduce income disparities. In the case of Pakistan growing inequalities have been highlighted as a serious problem. However, the budget fails to address the issue of inequality in a proper manner. More importantly, the largest relief measure (abolition of wealth tax) will exacerbate inequalities, because the benefit will accrue only to the rich. The 2 per cent turnover tax on retailers, like other indirect taxes, will be largely transferred to the consumers and have a disproportionately negative impact on the lower and middle income groups. In addition, the reduction in personal income tax rate will, of course, not benefit those below the exemption limit. But since the extent of reduction in tax falls with income, this relief measure is likely to benefit more the middle class.

Reduction in Distortions

According to the supply side economists broadening the tax bases normally hinge on the reduction in the tax rates that will increase the supply of goods and services, encourage documentation, discourage evasion and simultaneously discourage corruption. The recent attempts for the documentation include the three major steps: the ongoing tax survey, self-assessment scheme and tax amnesty scheme. The overall effect of these schemes depends upon the performance of the survey teams and on the honesty and accountability of the present and future officers of the CBR. Similarly, reduction in the income tax rates and maximum custom duty rates may discourage evasion, corruption and smuggling. Likewise, proposals of uniform tax on import stage of edible oil can potentially reduce distortions. Similarly withdrawal of the wealth tax should remove distortions in choice of assets for investment.

On the whole, it appears that the federal budget may lower some of the distortions existing in the economy through various measures. However, there still remain various segments of the economy where distortions exist and, in particular, more reforms are needed in sectors which are either untaxed or under taxed.

Ease in Tax Administration

A birds eye view of the last column of table 3 reveals that the most of the taxation proposals which are easy to administer and thereby, will be successfully implemented constitute measures of tax relief rather than additional tax generation. The most problematic area is the GST on retail trade which will prove difficult to administer because of the potentially large number of relatively small taxpayers who generally do not document their transactions. The tax survey should help in establishing the benchmark turnover of individual retail outlets, but getting traders to voluntarily comply with the new law will inevitably take some time and require tax education.

In conclusion, it can be said that one of the salient features of the budget is that it does not rely on the conventional approach of enhancing tax rates but instead focuses more on effective broadening of the tax bases, reduction in tax evasion and improvements in tax administration. This is a refreshing new approach and we hope that it will succeed.

Apparently, the main beneficiaries of the reliefs are the relatively well-off and the impact of the extension of the GST to retail trade is likely to hit more the lower income groups. However, the government has tried to balance the overall impact from the expenditure side by announcing a poverty reduction program including expansion of existing and development of new social safety nets.

THE DEBT TRAP

By
Dr. Aisha Ghaus-Pasha

Though the people have only recently been enlightened, Pakistan has been in a debt trap for quite sometime. Currently the outstanding public debt is 99.3 per cent of the GDP, that is, effectively almost all of the country's income is mortgaged (see Table 1). Outstanding external debt exceeds 400 per cent of our foreign exchange earnings. The comparable figures are 278 per cent for India, 195 per cent for Sri Lanka, 260 per cent for Indonesia and so on.

Is Debt a Recent Problem?

Viewed in the historical context, the debt problem has been in the making for a long time. Public debt was relatively high at the time of the break-up of the country. However, the upswing was controlled in the decade of the 70s whereby public debt-to-GDP ratio declined from 75 per cent to 48 per cent. The decade of 80s represents a dark era as the country was dragged very deep into the debt quagmire, undoing the efforts of the earlier decade. Domestic debt increased six times thereby nearly doubling the domestic debt-to-GDP ratio, while external debt increased over four times from Rs 74 billion to Rs 329 billion. As a whole, at the turn of the decade, total debt equalled over 92 per cent of the country's GDP.

The 90s have witnessed some stability in the overall debt to GDP ratio, which has increased to 99 per cent of the GDP by the end of the decade. External debt stands at 53 per cent of the GDP. This level had become unsustainable and the country was compelled to seek rescheduling of its external debt repayments through the Paris and London Clubs in 1998-99. It is important to remember that though the external debt relief has improved our liquidity, it has had the concomitant implication that since we are deferring repayment of our debt obligations, the underlying quantum of external debt is rising by the extent of the debt relief.

Why has Public Debt Increased Rapidly?

TABLE 1
DEBT TO GDP RATIO OF PAKISTAN
(% of GDP)

Years	External Debt	Domestic Debt	Total Debt
1979-1980	41.0	25.5	66.5
1984-1985	39.1	31.8	70.9
1989-1990	48.7	43.7	92.4
1990-1991	44.1	43.0	87.1
1991-1992	46.2	42.9	89.1
1992-1993	47.9	44.8	92.7
1993-1994	53.1	44.2	97.3
1994-1995	47.3	42.0	89.3
1995-1996	44.1	42.2	86.3
1996-1997	47.2	42.2	89.4
1997-1998	49.5	43.1	92.6
1998-1999	53.5	47.8	101.3
1999-2000 (E)	53.3	46.0	99.3

E = Estimated.
Source: Ministry of Finance, Government of Pakistan.

Rapid growth in public debt, represents the cumulative effect of financial indiscipline, poor use of fiscal resources and rising costs of borrowings. Fiscal deficits have remained high in Pakistan and a substantial part of government borrowings has been financed from non-bank sources (mainly saving schemes) at high nominal interest rates. On top of this the premature financial sector liberalisation in the early 90s led to a further increase in the cost of borrowing. The annual rate of growth of real debt (adjusted for inflation) was close to 10 per cent during the decade of the 80s. The primary reason why such a rapid growth did not cause even a more explosive growth in debt burden was the relatively high growth in GDP.

Unlike domestic debt, growth in external debt is essentially more of the 90s than a 80s phenomenon. The ratio of external debt to foreign exchange earnings was 250 pre cent at the end of 1980s has now risen sharply to about 416 per cent. The principal reasons for this crisis situation are the unsustainable level of current account deficits (ranging over 4 per cent of GDP), high capital losses due real exchange rate depreciation, stagnation of the exports, higher resort to relatively high cost short term borrowing due to the drying up of low cost long-term financial sources (primarily concessionary bilateral and multilateral funding, foreign remittances, etc.) and increase in real interest rates due to declining international inflation. On top of this, borrowed external resources have increasingly been used for consumption rather than investment implying

little or no enhancement in the debt repayment capacity. The country has been led into a dark alley whereby it has had no option but to get its external debt obligations rescheduled.

How heavy is the Debt-Servicing Burden?

Servicing of the high magnitude of both the internal and external debt puts an enormous burden on the public exchequer. Total debt servicing currently is Rs 305.6 billion, equivalent to over 52.8 per cent of current expenditure and 43 per cent of the total expenditure. As much as 74.2 per cent of net federal government revenue receipts are pre-empted by this single head of expenditure.

What are Options for the Future?

With the huge stock of external debt (approaching $ 36 billion) and annual debt servicing (in excess of US $ 4½ to 5 billion) will the country be able to service its debt obligations after December 2000 when the period of debt rescheduling comes to an end? Clearly, this depends upon what happens in the interim period. It will hinge primarily on to the extent of which we are able to improve the current and capital accounts of the balance of payments in the first part of 2000-01.

The critical factors in play appear to be export growth and restoration of confidence of foreign investors. In the absence of a rapid take off in exports, given the structural problems in our export sector, the current account is unlikely to improve dramatically in the next few months. It seems that Pakistan will have to achieve import compression of almost 15 per cent involving, on the one hand, tight demand management, including attempt at minimising the fiscal deficit, and, on the other hand, direct measures for restricting imports, including defence related imports. From a strategy currently of economic revival it will require a switch to a policy of virtually engineering a recession. Such a policy reversal could place the government in a embarrassing position.

Renegotiating with the IMF and other international agencies for a bigger amount of programme financing, including a second round of debt rescheduling, is the option being pursued by government. The track record of implementation of IMF conditionalities is not good,

particularly now after the discovery of fudging of the fiscal deficit numbers. A strong, front loaded programme, involving prior policy actions will apparently be needed to restore the credibility of commitment to the programme alongwith concessions of a more political nature.

The other ultimate option, of course, is repudiating our debt obligations, isolating Pakistan internationally and embarking thereby on the path of forced self reliance in the shortrun. Besides the other costs of taking Pakistan behind, in this option the elite of the nation, who have so far insulated themselves largely from the costs of structural adjustment, will have to tighten-up their belts and share in the pain. Are they ready to do this?

Altogether, Pakistan finds itself "between the devil and the deep blue sea", where easy options are not longer available. The growth of domestic debt will have to be controlled by bringing the budget deficit down, using the privatisation proceeds for debt retirement, improving institutional arrangements for better debt management and bringing down interest rates on domestic debt instruments in line with the fall in rate of inflation. However, the bigger short term challenge remains the management of the external debt.

What is the Government Doing in the Budget 2000-01?

The main focus of the budget 2000-01 as far as the debt problem is concerned are, first, an attempt at sizeable reduction in the budget deficit to 4.6 per cent of the GDP and second a cut in interest rates on NSS by 1½ per cent. The primary budget surplus is projected at over 2 per cent of the GDP next year. If this target is achieved then the overall debt to GDP ratio could fall by at least 2 per cent next year. Of course, this will also hinge on the effective real interest cost and the extent of exchange rate depreciation. Generation of even larger primary budget surpluses will be essential in coming years if the debt to GDP ratio is to be brought down rapidly.

The other significant development is that it is proposed to bring down interest payments in nominal terms next year even though the level of outstanding debt continues to rise. As shown in Table 2, these payments are targeted to fall from Rs 183.9 billion in 1999-2000 to Rs 175.4 billion in 2000-01. This will imply a reduction in the average interest cost on domestic debt from over 12½ per cent this year to 11 per cent next year, a drop of 1½ percentage points. It is

not clear how the average interest cost will fall by this much when it is only being reduced at the margin on new debt accumulated through the National Savings Schemes by 1½ percentage points.

Therefore, the assumption that interest payments on domestic debt will actually fall by over Rs 8 billion next year in the face of rising debt appears to optimistic. Also, it is disappointing that the three year macroeconomic framework announced in the budget does not indicate the target debt to GDP ratio in 2002-03 and the strategy which is proposed to be adopted to bring down the debt burden.

TABLE 2
INTEREST COST OF DOMESTIC DEBT

(Rs in Billion)

Years	Domestic Debt'	Interest Payments	Interest Cost (%)
1990-1991	406.2	35.7	8.79
1991-1992	479.5	50.3	10.49
1992-1993	560.4	62.7	11.19
1993-1994	647.7	77.5	11.96
1994-1995	742.3	77.9	10.49
1995-1996	846.8	104.5	12.34
1996-1997	970.2	126.5	13.04
1997-1998	1108.1	167.5	15.11
1998-1999	1280.3	175.3	13.69
1999-2000	1468.3	183.9	12.52
2000-2001	1591.0	175.4	11.02

' at the middle of the year, that is, end December

DEVELOPMENT PRIORITIES

By
Zafar H. Ismail
Abu Nasar

The Public Sector Development Programme - the compendium of public works to be executed during the year - has been the "*development*" priorities' barometer of governments. Their relevance to five year programmes is only incidental. The PSDP is the joint product of the Planning Commission and the Finance Division. Each successive government has its own priorities and if governments change part-way in a year these allocations could be changed to reflect the change. During 1999-2000 General Musharraf took over from Nawaz Sharif. Each have professed different priorities. These are reflected for the Nawaz governments in the budgetary allocations for the year 1999-2000 and for the Musharraf government in the revised estimates of development spending for 1999-2000 and the budgetary allocations for 2000-01.

The size of the PSDP for 1999-2000 was reduced by the Musharraf government from Rs 116.3 billion to Rs. 100.6 billion and in the process the priorities were reassigned (see Table). With regard to the share of allocations to the development of the social sectors and the economic infrastructure executed through the Federal ministries the former's share was reduced from 6.1 per cent to 5.7 per cent and the latter's from 28.7 per cent to 19.4 per cent. The social sectors saw the halving of allocations for education and about a 5 per cent cut-back in health. The major changes to allocations for building the economic infrastructure during the year were the cutbacks of Rs. 2 billion in the Water sector, Rs. 1.7 billion in the Power sector, Rs 2 billion in the physical planning and housing sector, Rs. 7 billion for rural development, and Rs. 3.1 billion in the Tameer-e-Sindh and Tameer-e-Watan Programmes. These were offset by the *de nuovo* allocation of Rs. 3.5 billion for the Integrated Rural-Urban Development Programme. WAPDA's PSDP allocation saw a net increase of over 31 per cent. The Provincial ADPs were cut back by Rs. 4.6 billion. The share between SAP and non-SAP allocations are yet to be revealed.

TABLE
PSDP OUTLAYS

SECTORS	Amount Allocated *(Rs in Million)*			Share in Allocations		
	1999-2000		2000-01	1999-2000		2000-01
	Budget	Revised	Budget	Budget	Revised	Budget
SOCIAL SECTOR	**7,148.9**	**5,759.9**	**6,672.7**	**6.1%**	**5.7%**	**5.5%**
Education and Training	1,622.7	821.4	1,194.1	22.7%	14.3%	17.9%
Health and Nutrition	2,690.3	2,538.3	2,841.4	37.6%	44.1%	42.6%
Women Development	50.0	30.0	46.7	0.7%	0.5%	0.7%
Population Welfare	2,200.0	2,093.1	2,200.0	30.8%	36.3%	33.0%
Manpower and Employment	84.4	17.0	21.0	1.2%	0.3%	0.3%
Mass Media	130.0	66.7	126.9	1.8%	1.2%	1.9%
Culture, Sports, Tourism & Youth	276.4	103.9	138.2	3.9%	1.8%	2.1%
Social Welfare	95.1	89.5	104.4	1.3%	1.6%	1.6%
ECONOMIC INFRASTRUCTURE	**33,422.7**	**19,489.7**	**27,242.0**	**28.7%**	**19.4%**	**22.6%**
Water	11,288.9	9,266.5	10,077.9	33.8%	47.5%	37.0%
Power	2,963.0	1,214.0	2,682.5	8.9%	6.2%	9.8%
Transport and Communications	3,186.5	2,852.9	4,057.1	9.5%	14.6%	14.9%
Physical Planning and Housing	3,184.7	1,187.9	1,748.5	9.5%	6.1%	6.4%
Rural Development	10,537.2	3,221.0	2,419.8	31.5%	16.5%	8.9%
Fuels	1,170.0	977.1	2,238.7	3.5%	5.0%	8.2%
Science and Technology	423.3	140.4	2,870.5	1.3%	0.7%	10.5%
Research, Statistics & Planning	394.2	356.0	860.0	1.2%	1.8%	3.2%
Environment	274.9	273.9	287.0	0.8%	1.4%	1.1%
PRODUCTIVE SECTORS	**587.1**	**573.2**	**1,029.6**	**0.5%**	**0.6%**	**0.9%**
Agriculture	289.1	157.2	329.2	49.2%	27.4%	32.0%
Industry	260.0	408.0	692.3	44.3%	71.2%	67.2%
Minerals	38.0	8.0	8.1	6.5%	1.4%	0.8%
Special Area	**4,048.0**	**4,200.0**	**4,705.3**	**3.5%**	**4.2%**	**3.9%**
Special Programmes	**3,600.0**	**4,000.0**	**5,600.0**	**3.1%**	**4.0%**	**4.7%**
Tameer-e-Sindh Programme	500.0	100.0	)	13.9%	2.5%	)
Afghan Refugees Programme	100.0	100.0	100.0	2.8%	2.5%	1.8%
Tameer-e-Watan Programme	3,000.0	300.0	)	83.3%	7.5%	)
Integrated Rural-Urban Development Programme	)	3,500.0	)	)	87.5%	)
Integrated Small Public Works Programme	)	)	5,500.0	)	)	98.2%
Corporations	**38,685.0**	**42,292.0**	**30,483.0**	**33.3%**	**42.0%**	**25.3%**
WAPDA (Power)	11,988.5	22,194.0	14,983.0	31.0%	52.5%	49.2%
Village Electrification	7,500.0	1,500.0	500.0	19.4%	3.5%	1.6%
OGDC	96.5	)	)	0.2%	)	)
National Highway Authority	19,100.0	18,598.0	15,000.0	49.4%	44.0%	49.2%
Provincial Programmes	**28,800.0**	**24,285.2**	**44,700.0**	**24.8%**	**24.1%**	**37.1%**
Provincial SAP	16,000.0	)	10,300.0	55.6%	)	23.0%
Provincial IPSPWP	)	)	15,700.0	)	)	35.1%
Provincial Annual Development Programme	12,800.0	)	18,700.0	44.4%	)	41.8%
TOTAL PSDP	**116,291.7**	**100,600.0**	**120,432.6**	**100.0%**	**100.0%**	**100.0%**

How has the Musharraf government re-prioritised its development goals in the light of its avowed intentions to revitalise the economy, fight poverty and provide relief to the downtrodden masses. The overall size of the PSDP has been increased by about Rs. 20 billion next year over the revised estimates of spending this year. This represents an increase of more than 20 per cent over the outgoing year. A comparison between its use of funds sectorally during 1999-2000 (as indicated by the revised estimates) and the allocations this year reveals that while the allocations to the social sectors have increased in absolute terms by about Rs. 1 billion, their share in the overall scheme of development has been reduced further by 0.2 percentage points to 5.5 per cent for the coming year. The building of economic infrastructure has been allocated an additional Rs 8 billion, raising its share from 19 per cent to over 22.5 per cent. Allocation to the Water sector has been increased by only Rs. 1 billion, the bulk of it for drainage schemes. However, the share for the building of economic infrastructure has declined substantially - by 10 percentage points. Allocations for Science and Technology have jumped 20-folds from a small base, the bulk of which is for the development of Information Technology (details unknown). Allocations to the Special Programmes have increased by Rs. 1.6 billion. The Tameer-e-Sindh and the Tameer-e-Watan Programmes have been eliminated from the basket of projects as has the Integrated Rural-Urban Development Programme. Their allocations have been transferred in entirety, alongwith an additional Rs. 1.6 billion, to the Poverty Alleviation Programme - the so-called Integrated Small Public Works Programme.

The main cut-back has been in the allocations to the Corporations - about Rs. 8 billion from WAPDA and Rs. 3.5 billion from the NHA, which appear to have been allocated to the Provincial component of the ISPWP. The latter also appears to have been allocated an additional Rs. 4 billion from other resources available to the government. There appears to have been a contra-entry between the provincial SAP and non-SAP allocations. The former having been cu-back by Rs. 5.7 billion and the latter having increased by a somewhat similar amount.

The question that immediately leaps to the mind of the discerning individual is - Has the Musharraf government addressed issues of burning importance adequately? Poverty alleviation can be tackled in two very different ways. One is through short-term income transfer mechanisms and the other through long-term empowerment of the people. SAP the

government's flagship for improving social indicators and reforming - nay, transforming - the delivery of social services to empower the people has been the whipping post for the gulf between pious hope and tall promises on the one hand and government inaction and apathy on the other. However, allocations to the SAP have been cut back, which in itself may not be wrong. Historically the line departments have been unable to use the full quantum of funds allocated. Is this cut-back a statement of intent by the government that it is finally willing to bring about the reforms which have been oft advocated by donors and beneficiaries alike? One sincerely hope so, but there is no indication that this is being undertaken. There appears to be no plan of action which has been unveiled for this purpose either at the federal or the provincial level. The Poverty Alleviation Programme as enunciated in the budget is an example of the former mechanism. One wonders whether the government is committed to which - the creation of a horde of individuals dependent on an insufficient level of dole and unable to break out of the poverty trap, or people who will be able to pull out of the rut of poverty because they have been empowered through the transfer of skills and knowledge, are healthier and are more nourished?

One burning issue today is the plight of regions which have been impacted by drought. This phenomenon has not crept upon us overnight. It has been building up over time and has only now hit us in a disastrous manner. The Government has been forced to declare a natural calamity in these regions. Is any action being undertaken to redress this problem? For the last several months there have been statements by ministers, senior bureaucrats and the brass at both the federal and provincial levels that plans are being formulated for disaster relief and for long-term measures to overcome this menace. This should have been reflected in the PSDP this year through substantial additions to the water sector to create water reservoirs and recharging aquifers. An examination of the PSDP allocations for the outgoing year reveals that no new projects for either category were started or were being undertaken by any Federal Ministry. A similar situation would appear to hold true this year. In fact, the bulk of allocations to Water during the outgoing year were, and again for the coming year are, for the major drainage projects. These major engineering projects are amenable to the strengthening of the contractor-engineer nexus and the exploitation of economic rents. The true impact of the drought will be felt in the years to come unless we have an abundance of rain - and the weather pundits are not

optimistic. Water resources can be augmented in a variety of ways quickly, the construction of a series of small check dams and wiers, the development of aquifer recharge projects to replenish the over-exploited underground water resources and the proper utilisation of the existing quantum of water through on-farm water management, modern technology or lining the canals. It may well be argued that some of these fall within the domain of the provincial governments. If so, how have the provincial governments behaved in the face of this natural disaster?

The ADPs for both Sindh and Balochistan were analysed as these are the two provinces which have felt the bulk of the impact of the drought. An analysis of the allocations for the water sector by Sindh in the outgoing year indicate that the utilisation of the allocation was very poor. A total of Rs 303 million was allocated. Of this Rs 121 million were allocated to new schemes all of which were devoted to providing crossings over the river, and minor extensions to the irrigation network. None of these were, however, started. In the proposed ADP for 2000-01, these have not been included. No projects for mitigating the impact of drought in Tharparkar, Mithi, Mahal Kohistan, Dadu, Nawabshah or Khairpur have been proposed. New projects are for remodelling canal gates, desilting one canal and improvements to the main feeder for transporting drinking water to Karachi. Balochistan, on the other hand appears to have addressed the issue of scarcity of water resources. In both the outgoing and the ensuing year they have allocated funds for delay action dams in a number of districts as part of a long term strategy. In the upcoming year, the Balochistan Government has proposed to construct check dams for aquifer recharge. These alone can be said to be a direct response to mitigate the impact of the drought.

All in all, no fundamental changes in priorities are proposed in the PSDP for 2000-01, although there appears to be significant repackaging and renaming of different programmes. Positive developments include a higher share of the provinces in the overall PSDP, greater emphasis on public works for employment generation and poverty alleviation and increased recognition of the need to invest in science and technology. Worrying aspects, in particular, are the reduced emphasis on the development of the social sectors and lack of assignment of top priority to allocations for the water sector for resolving the problem of the drought.

FEDERAL TRANSFERS TO PROVINCES: SOME GROWTH AT LAST

By
Dr. Aisha Ghaus-Pasha
Naveed Aamir

In the last few years the four provincial governments have witnessed a significant deterioration in their state of finances largely due to the stagnation in intergovernmental fiscal transfers. Following the implementation of 1996 National Finance Commission (NFC) award, federal transfers plummeted by about 5 per cent, increasing subsequently by only 3 per cent in 1998-99. The provinces attributed the decline solely to the design of the 1996 NFC awards, naively ignoring the significant adverse impact of other factors like the tax reforms, which coincided with the implementation of the 1996 NFC award and the tapering off of the growth momentum of the economy. Now that the once and for all impact of the tax reforms has already been registered and the economic growth has partially been restored federal transfers have started to demonstrate some buoyancy. Fortunately for the provinces, revenue transfers from the divisible pool have increased by about 14 per cent while straight transfers have registered a growth of 28 per cent, increasing the overall transfers by 15½ per cent from Rs 136 billion to Rs 157 billion in 1999-2000 (see Table 1).

TABLE 1
FEDERAL TRANSFERS TO THE PROVINCES

(Rs in Billion)

	1996-1997	1997-1998	1998-1999	1999-2000 (RE)	2000-2001 (BE)
Divisible Pool Transfers	119.2	104	107.7	122.7	149.9
Straight Transfers'	18.6	20.5	20	25.6	38.6
Special Grants	0.7	7.4	8.2	8.7	9.8
Total Transfers	138.5	131.9	135.9	157	198.3
Annual Growth Rate (%)	)	-4.3	3	15.5	25.3

' Includes profits from Hydro Electricity

Source:
Federal Budgets in Brief
Provincial Annual Budget Statements

The federal budget 2000-01, proposes a growth in transfers to provinces of over 26 per cent, increasing to Rs 198 billion. Of course the underlying assumption is that CBR revenues attain a buoyancy of about 24 per cent, which has already being questioned in the media and by

professional economists. Also, the projections assume an increase of over 50 per cent in straight transfers, which appears optimistic and hinges crucially on a major hike in gas tariffs. As such, the first issue that arises in the context of the federal budget 2000-01, is the feasibility of the increase in revenue transfers of over Rs 41 billion.

Provincewise growth in transfers is given in Table 2. Balochistan and Sindh are the main recipients of straight transfers, hence these are likely to experience a somewhat higher growth in transfers. In the case of NWFP the capping of profits from hydro electricity profits has restrained the buoyancy of transfers.

TABLE 2

PROVINCEWISE GROWTH IN TRANSFERS

(Rs in Billion)

	1999-2000 (RE)	2000-2001 (BE)	Growth Rate (%)
Punjab	73.4	93.5	27.3
Sindh	38.7	49.5	27.9
NWFP	26.5	31.6	19.2
Balochistan	18.4	23.6	28.3
TOTAL	157	198.3	26.3

Source: Federal Budgets in Brief
Provincial Annual Budget Statements.

The second concern is in the context of general sales tax (GST) on services. As per the constitutional provision, GST on services falls in the purview of provincial fiscal jurisdiction. If for the sake of levying an integrated value added tax, GST on services is proposed to be collected by the federal government instead, it is important that the spirit of fiscal autonomy be respected, and revenues be reverted back to the province from which they are collected. The very fact that GST on services is reported alongwith straight transfers in the federal budget documents is an indication that the federal government intends to do so. However, the respective

provincial breakups are currently on the basis of population. One hopes that these will be revised and instead 'collection' is used as the bases of final distribution among the provinces.

The federal budget documents have assumed self-financing of PSDP by the provinces of the tune of Rs 31 billion. Budget of all the provincial governments have not yet been announced. However, if Sindh is taken as an example, self-financing of Rs 4.5 billion, instead of Rs 6.6 billion projected by the federal government in arriving at the figure of Rs 31 billion has been anounced. This raises doubts about the feasibility of the size of the provincial development programs as well as the overall budget deficit targets.

If the feasibility of revenue transfers is ignored and it is assumed that transfers will take place as projected in the federal budget 2000-01, the next level of concern is regarding the use of the additional transfers. A historical analysis of the behavioural impact of fiscal transfers on provincial finances reveals that a one rupee increase in federal transfers leads on the average to a 35 paisa decline in provincial own revenue mobilisation and a 65 paisas increase in expenditure. Will we witness a repeat of this behaviour following an additional federal transfer of over Rs 41 billion? Will the provinces dole out tax breaks and slacken on their fiscal effort? If so, what will be the motivation to develop the agricultural income tax which is just about to gain momentum? Will we witness profligacy in provincial current expenditures? Will there be a rise in 'social' employment? Or will we witness a reduction in borrowing and thereby a reduction in debt accumulation? The key question is will the provincial finance managers of this new government be more financially prudent than their predecessors. Already, two provinces, viz, Balochistan and NWFP, have proudly announced ' no new taxes' in their budgets.

AN INCOMPLETE BUDGET

By
Dr. Aisha Ghaus-Pasha

The budget for 2000-01 has come as a pleasant surprise. In the first part of the Budget Speech when the Finance Minister announced that the fiscal deficit was going to be reduced sharply from 6.1 per cent of the GDP this year to 4.6 per cent of the GDP next year there was immediately an apprehension that in the second part of the speech heavy taxation proposals would be announced to achieve the steep deficit reduction. Instead, a number of significant reliefs have been announced including abolition of wealth tax, reduction in personal income tax, etc., but despite these concessions and no major taxation proposals, CBR revenues are expected to increase by as much as 24 per cent next year which will greatly help in bringing down the fiscal deficit.

A lurking suspicion remains. Is this all too good to be true? There are it seems two possibilities. The first possibility is that the government has put all its eggs in the basket of the tax survey and documentation of the economy which by establishing the turnover of retailers will lead to a bonanza of revenues from the newly imposed GST on retail trade and by cutting into tax evasion generally will lead higher direct tax revenues through the detection of a large number of new income tax payers and also reveal the extent of underdeclaration by existing tax payers. If the tax survey is successful them this would go a long way in achieving the ambitious target of increase in CBR revenues by Rs. 84 billion in 2000-01.

The second possibility is that the announcement of taxation and other proposals, which could contribute significantly to increasing revenues or reducing subsidies, but which could hurt the so-called ‘common man’, has been delayed for a more opportune time. The likelihood of this increases if the tax survey fails to yield sizeable additional revenues in the short run or if during subsequent negotiations with the IMF over the next three months, dissatisfaction is expressed by donors with the quality of the budget in terms of ‘hard’ taxation proposals or well-defined steps for containment of expenditure to achieve the steep target for deficit reduction. It is in this respect that the budget is incomplete. The delay of the decision by the IMF regarding the nature

of the future program with Pakistan till upto the end of September 2000 may indicate that the Fund proposes to watch the fiscal performance during the first quarter of the next financial year, especially that of tax revenues, before it agrees to a program.

What then are the likely candidates for subsequent announcement by the government in order to meet the budgetary targets? An immediately obvious one is the enhancement in gas tariffs. The budget estimates show almost a 50 per cent increase in revenues from the gas development surcharge, which is expected to fetch revenues of Rs. 15 billion in 2000-01 as compared to Rs. 10.2 billion this year. Such a large increase is possible only if gas prices are raised substantially and the Ministry of Finance publication, Explanatory Memorandum on the Budget, already talks of a price adjustment. It is not surprising, therefore, that soon after the announcement of the budget, the Minister for Petroleum and Natural Resources has strongly hinted at the likelihood of an impending hike in gas tariffs. So, owners of fertilizer, cement and power plants may brace themselves for an increase in input costs while domestic consumers may prepare themselves for a type of hike in gas bills that they have got used to in the case of electricity bills. Apparently, gas tariffs will have to be increased by over 50 per cent in the next three years to attract private investment in the sector.

What else can we look forward to ? The Finance Minister has in the Budget Speech indicated that announcement about reform of the agricultural income tax will be made by the provincial governments in their respective budget statements. Apparently, an understanding has been reached with the IMF and the World Bank that the present tax will be replaced by a uniform AIT, which will be introduced simultaneously in all four provinces with possibly the following features: a general acreage based tax with no exemption threshold and for relatively large farms, taxation of agricultural income as any other income. This is consistent with the announcement by the Chief Executive in his Economic Revival Plan on the 15th of December 1999 that agricultural income should be treated like any other income for tax purposes.

But despite the commitment made by the Finance Minister, the two provincial governments, Sindh and Balochistan, that have already announced their budgets for 2000-01, have made no explicit statement about the imposition or reform of the agricultural income tax in their

respective provinces. Punjab is the only province which appears to have proceeded with a proper income based AIT. Why is there such a delay by the other provinces in implementation of the policy statement made by the Chief Executive over six months ago regarding the agricultural income tax? Surely by now the ordinance for promulgating this tax should have been prepared for announcement simultaneously in all the provincial budgets or has the government met with stiff resistance from the feudal lords in parts of the country which is delaying the imposition nationwide of a proper agricultural income tax? Perhaps, further prodding by the IMF is necessary for the government to develop the necessary motivation to surmount the pressures of the powerful agriculturalists lobby. The military government, given the powers granted to it for amending the constitution by the Supreme Court, has the ultimate option, of course, of federalising the agricultural income tax if the provinces continue to drag their feet in implementing this reform.

What next? The wheat procurement price was raised by 25 per cent earlier this year and it has already yielded handsome results in the form of a bumper crop. But in the absence of a corresponding increase in the issue price of wheat the subsidy bill of the provincial governments will rise drastically. The increase in issue price was probably not announced in the federal budget because of the fear that the consequential rise in the retail price of *atta* would lead to a strong backlash from urban consumers, who are already feeling the pinch of rising petroleum (and transport) prices. Nevertheless, the government's economic team has apparently also committed to the IMF in the recent discussions that the issue price of wheat will be raised shortly by 25 per cent. Therefore, will such an announcement be made before the arrival of the IMF mission in July for formal negotiations on a future program of support?

What are the other shocks that are likely to be registered on the people in coming months? WAPDA's operating profits have been significantly eroded in recent months due to the steep increase in price of furnace oil and its liquidity position continues to be impaired by the accumulation of arrears by provincial governments and other government entities. How long will WAPDA continue to suffer the higher input costs and liquidity problems before making a reference for higher power tariffs? Here again, the economic team has probably made a

commitment to the World Bank and IMF that there will be a ‘timely adjustment’ in WAPDA tariffs.

Finally, possibly after the next sowing season, the government may implement another important conditionality of the IMF which relates to the withdrawal of GST exemption on agricultural inputs like fertilizer, pesticides, seed and agricultural machinery, including tractors. Hopefully this highly undesirable move with deleterious effects on agricultural production can be avoided if meanwhile a proper agricultural income tax is introduced.

The above list of actions which may be undertaken in subsequent weeks and months primarily on the behest of donors, to arrest the sorry state of Pakistan’s finances and qualify for the next programme of assistance (including debt rescheduling), indicate that we are in for a series of measures after the budget which could relate to gas and electricity tariffs, issue price of wheat, imposition of a proper agricultural income tax and GST on agricultural inputs, etc. A potentially tough budget was probably softened considerably by excluding these announcements from the Budget Speech on the 19th of June. Instead, the practice followed by previous governments of post-budget announcements (that is, administering bad news in small doses) may have been chosen as the pragmatic way out. The Finance Minister has, of course, indicated that there is no possibility of any mini-budgets during the course of the next financial year. We sincerely hope that he is able to live up to this promise.

THE REFORMS AGENDA OF THE BUDGET

By
Zafar H. Ismail

Once again this year, the budget, both overtly and covertly, promises to bring about substantial changes in how the government will mange its finances. The budget estimates that in the absence of any new proposals, over Rs. 84 billion will be collected from the existing taxes. The relief measures and additional taxation levies announced by the Finance Minister in his speech are expected to result in net loss of Rs. 2.8 billion. Thus the expected increase over last year's revised estimates has been pegged at nearly Rs. 81 billion, the bulk of which will come from Sales Tax (Rs. 53 billion). Income Tax will yield an extra Rs. 26 billion, of which Rs. 6 billion is expected to be the additional Wealth Tax generated from the Tax Amnesty Scheme and the Tax Survey. Changes in the Customs Duty regime are expected to net an additional Rs. 6 billion. The budget makers also expect that due to a shift from Central Excise to Sales Tax on a number of items, the yield from the former would reduce by about Rs 4 billion.

The bulk of these are to be the result of improvements in tax administration. The budget also lays emphasis on the need to ensure that the mistakes of the past are not repeated, thus, both stabilising the economy and poverty alleviation are the driving forces in preparing the budget. Changes are promised in two key areas - the administration of taxes and the management of finances. Another change promised is in the financial sector. Yet another is the devolution of responsibilities to the grass-roots level. A plethora!!!! Are these repeats of previous years - **tall promises and no action**? While actions prior to the announcement of the budget indicate that this time round the government will implement, nevertheless, the question still remains - **will** the further action promised be partial or full? If partial, then it is a prescription for failure.

Changes in Tax Administration

The finance wizards of the country are apparently relying heavily on the recently launched Tax Survey to achieve the targets for the next year. To quote the Finance Minister, "*Thus documentation is not just an instrument of collecting more revenues. It is the basic tool for establishing a just, fair and equitable system of state management*". Thus the Survey is expected to provide information for widening the tax base of both Income and Sales Taxes, to increase the

yields from existing tax payers and to provide a data base which could be tapped into by the provincial governments to improve their yield from Property Tax and Tax on Transfer of Property. This requires that the tax administrations at the federal and provincial levels are vertically integrated operationally. The Tax Survey will provide information on both movable and immovable assets, the ownership and valuation records of which are maintained by both the federal and provincial governments. The provinces require information on rental income which lie within the domain of the Income Tax authorities. Traditionally there has been little or no cooperation between the two tiers. A previous attempt at such integration through the collection of CVT and Withholding Income Tax on motor vehicles and on information sharing regarding Income Tax Payers for the levy of Professional Tax have been dismal failures. The former resulted in an increase in evasion in the payment of Motor Vehicles Tax and the latter did not even materialise.

The Survey is expected to be the backbone for assessing/re-assessing incomes. All that is asked of from rentiers are their sources and levels of income, expenditure on utilities and rent, and details of vehicles owned. Property owners are required to give the date of acquisition also. Business owners and partners are required to provide the foregoing details for both the business (other than income) and sel(f)ves and in addition give the education expenses incurred on his/her/their children and the value of stock in trade. From this very scanty information the tax authorities are expected to wring an additional Rs 20 billion as Income and Wealth Tax.

The likelihood of any significant gain from the rentiers and the landlords is minimal. Whatever gains that accrue will arise from cross-matching the information on rents paid to landlords with the income returns filed, and the history of incomes declared (thus an estimate of accrued savings) and the acquisition of assets. This will require special skills. Does the Income Tax Department have them? Will the survey also extend to rural properties and land-holdings which are rented out - both in cash and in kind (share-cropping)? If not, then this whole Survey can be challenged on the principles of equity in law.

Earlier, the Information Technology Commission had brokered a bridge between the utility companies, the Tax Policy Wing of the CBR and the Pakistan Revenue Automation Limited and

had provided the in-depth knowledge needed to use the several data bases from the utilities, the Federal Bureau of Statistics and the Income Tax Department to identify a possibility of an additional 2 million tax payers. The CBR has used this only partially. The Survey provides sufficient data to reactivate this methodology. Will the IT/ST Departments, the Tax Policy Wing, PRAL and the utilities be able to broker the coordination and partnership needed to gain from the information needed. If history is any indicator, then this will not be done - largely as this will erode the economic rents accruing to the vested interest groups within each organisation.

However, Mr. Shahid Hussain from the World Bank is expected to arrive shortly and wave a magic wand and transform the dinosaur that is CBR into a panther - that is, a professional body driven not by archaic systems and procedures and manned by highly trained, motivated and honest professionals. Something that can only be achieved over a few years.

The extension of the Sales Tax net is to be achieved through voluntary registration through the 2% Turnover Tax. Information from the Survey can be utilised to monitor compliance. The greatest benefit would, of course, accrue if both the administration of the Sales Tax and the Income Tax can be merged into one and provided CBR is able to establish the correlationship between Income (Profit), Value of Stocks, Gross Sales, Capital Employed and consumption of utilities. This relationship will, however, depend on the type of commodities handled - information for this and income has not been sought. Apples are not equal to oranges. Moreover, vested interests within CBR will fight the merger of the Sales and Income Tax Departments. They will, of course, be helped by the traders - Sales Tax is a pass through tax, Income Tax is not.

Without any major rate changes in Customs Duty, the government expects to collect an additional Rs. 6 billion. This is to be achieved through one major change in the operations of the Department - reliance on inspection and valuation rather than on the verification of documents. Over the last few years, the valuation skills of the Department must have eroded because of dis-use and natural attrition. These would now have to be re-furbished rapidly - not

the easiest of tasks. The Department should seriously consider contracting this service out to the large body of valuers available with the Insurance Companies.

Management of Finances

A major reforms which Mr. Shaukat Aziz has referred to is the management of resources. To this end the Musharraf government has, as part of the budget speech, promised "*To institute a transparent system of expenditure control and to effect material austerity in public expenditures*". To be able to achieve this very laudable objective of good governance, a four pronged approach is being adopted. Civil Service Reforms are promised. The first steps for this have preceded the budget - changes in the Efficiency and Disciplinary Rules (permanent non-terminable employment no longer their right) with more to come (merit and skill based career progression). This is to be coupled to rightsizing the government with action plans for the most powerful citadels (Ministry of Finance and the CBR) due to be overhauled respectively by end-June and end-December this year. Will the government unveil these for public debate? One hopes that it will abide by its promise to be transparent. This is both an implicit commitment which comes through loud and clear from the budget speech and an explicit content of the budget. To quote "*To allow public oversight over expenditures, it has been decided that expenditure figures would be released on a monthly basis. This information would be available on the web site of the Ministry of Finance starting August 2000 when the details of expenditures during the month of July would be made available*". This, one hopes, will be the prime function of the Fiscal Monitoring Committee and will include the issue of debt figures also. The government should not be shy in seeking help in establishing monitoring systems which are more than abundantly available with any large private sector group - both domestic as well as international. No organisation, whether public or private, can function efficiently without such systems.

Devolution of Responsibilities to the Grass-roots Level

Mr. Shaukat Aziz has correctly analysed the rot of the institutional framework when he says : "*The capacity of the state to meaningfully impact the lives of its citizens has largely been eroded. It is not merely the lack of resources that explains the poor state of social indicators. Rather, the institutions engaged in providing social and economic services, such as education, health and*

social welfare, have lost the capacity to deliver them to the target population. Thus no amount of additional resources could help the situation unless these institutions are reconstructed and revitalized".

One of the cornerstones for this budget and the three-year economic revival strategy is poverty alleviation. The Government proposes to use four mechanisms to achieve this, but places reliance on local government institutions to deliver three of these programmes: the Small Public Works Programme, the Food Stamps Programme, and the Social Action Programme. The mechanisms for the Micro-Credit Programme have yet to be firmed up.

The Small Public Works Programme is a district level initiative which will be delivered "*under the guidance of provincial governments*", to be supervised through the Army Monitoring System and the participation of local communities in the identification of schemes. The Programme is designed to be spatially targeted for the "*greater application of funds to areas facing extreme backwardness*". All of these are laudable objectives. Local governments are moribund organisations today without any "*local community*" participation. They will be replaced by a whole range of institutions which have conflicting responsibilities, targets and objectives according to plans floated by the National Reconstruction Bureau. Some of these will be elected others appointed. They are all going to be dependent on bureaucrats drawn from the provincial departments who will thus be pulled in two different directions - administratively to the province and technically towards the institutions they will be serving. Two captains on one ship!!!!!! Further, it will take time to create the institutions, systems and procedures, organisation and mechanisms needed to ensure that the delivery is transparent and efficient. The likelihood of the programme making significant inroads on poverty in the first year or two is remote.

The Food Stamps Programme is "*essentially designed to mitigate the impact of adjustment in the wheat support price*" This is a federal programme to be delivered through the district food support and Zakat committees and monitored through the Army Monitoring System. The actual distribution of the food stamps to about 1.2 million households in civil society (not including those of public sector employees) earning less than Rs. 2,000 monthly will be through the post offices and Bait- ul-Maal. Given the horror stories of the loot that went on in the Bait-ul-Maal

disbursements earlier one shudders to think of what will happen. Implicit in this whole scantily detailed programme is a means test approach to disbursement. One would assume that the food support and Zakat committees would be the vehicles for administering the means test. If these committees are full of men of integrity, then the means tests would result in correct targeting. But why limit this to only 1.2 million households? Once again it will take time first to clean the stables of the Bait-ul-Maal and the Zakat Committees, set up the food stamp committees, the mechanisms for means test and the distribution channels. Once again the full benefits of the programme will only begin to be felt substantially later on in the year rather than immediately.

The SAP has been in existence now since 1992-93. It is being delivered through the relevant line departments of the federal and provincial governments. Each successive review, audit and appraisal has been critical of the ever increasing cost-ineffectiveness in the delivery of the programme and has requested for major institutional reforms. Nothing has been done to implement the reforms suggested nor improve cost-effectiveness. Community participation is conspicuous by its absence. SAP is seen as the only vehicle through which people would be empowered to overcome poverty. However, as has been the case in the past, the budget has not promised any radical changes. The Musharraf government says it is committed to poverty alleviation, yet it has reduced the provincial allocations to SAP by nearly Rs. 6 billion. It says that it is committed to institutional reform, yet it has not indicated any change in the delivery mechanisms for SAP. If this programme is to continue to be routed through the (inept? corrupt?) line departments without effective participation by local communities, then we will continue to have more of the same - major haemorrhaging in the use of funds.

The Micro-Credit Programme is being delivered through a to-be-created micro-credit bank. The Habib Bank, The First Women's Bank, the Pakistan Poverty Alleviation Programme are all engaged in this activity. There is a network of other public sector banking organisation with an outreach to the village level which already exists. Why a new bank for this special purpose? The cynic would argue - to create employment for the chosen few. Why could the existing institutions not be cleaned up, re-furbished and re-directed? Would this not have been far more cost-effective? Or is this government like any other - pious in its statements only?

This budget has promised a lot of action towards reforms, but the legislation needed for the changes promised has not been announced. Its sincerity to bring about these changes promised can only be gauged with the passage of time. I can only join with Mr. Shaukat Aziz when he prays "*I seek the guidance and help of Allah that he enable us to achieve the targets we have in the budget*".

A BANK FOR THE POOR AS WELL: CONTINUING OPTIMISM

By
Haroon Jamal

Poverty has become the primary concern of developing countries during the last decade. Macroeconomic policies support the traditional approach, in which poverty is deemed to be alleviated by top-down money transfers initiated by the State. The public money transfers to the poor, via safety nets, have had little effect on poverty and at the same time were financially and politically costly to set up and implement. The new bottom-up approach broadened the scope of anti-poverty policies and gave a special role to credit in the overall poverty eradication process. In this approach, money allocated by governments and donors to specialized intermediaries is transformed into small credit extended to the poor, allowing them to develop income-generating activities. Among the first and most publicized example of bottom-up efforts to fight poverty, the Grameen Bank of Bangladesh went so far as to call credit 'a right of the poor'.

The present government as well as donor agencies in Pakistan are striving to enhance the role and scope of microcredit or microfinancing, as an integrated effort to alleviate poverty in the country. In his speech, the Finance Minister categorically said that the Government has completed the necessary preparatory work for launching of the micro-credit bank. He mentioned that experts are busy developing a framework for the bank and that first operations of the bank will be launched on 14th August 2000.

The existing evidence of microcredit impact on poverty is not clear-cut and straightforward. There is some research which suggests that access to credit has the potential to significantly reduce poverty; however, on the other hand, some other research studies argue that micro-credit has minimal or no impact on poverty reduction.

The Proposal

The mechanism that the Government is considering for the Micro Finance Bank (MFB) has been extracted from the executive summary of the consultant's report on the proposed MFB. The report was circulated to NGOs, involved in microcredit for their comments and suggestions.

The proposal is to establish the proposed MFB as a banking company under the Banking Companies Ordinance initially to take over the micro-finance operations of participating regional and national Rural Support Programs (RSPs). The strategy entails that the MFB to 'buy-out' the loan portfolio, staff and facilities of existing RSPs. The required paid-up capital of one billion rupees to achieve its targets will be met partially through the equity contributions of the RSPs. The RSPs expected to draw on their endowment funds for those contributions. The remaining equity will be offered to commercial banks and other investors. Direct government investment in the bank would be limited to non-voting preferred shares. It is proposed that no single investor will hold majority shares.

The Promises

The proposed strategy will enable the MFB to have an operating structure and clientele that it can be expanded rapidly. Therefore, the prospect of maximizing the outreach of microenterprise finance is optimistic. It is expected that, starting with the existing 65,000 borrowers and a total outstanding portfolio of Rs. 800 millions, an additional 80,000 borrowers would be added each year. After seven years, the MFB is projected to have a loan portfolio with an outstanding of Rs. 9.5 billion to 615,000 borrowers in 53 districts of Pakistan. This is expected to be achieved with the help of 1,200 field staff (up from 100) and a backup of 830 administrative staff (up from 402).

The Concerns

From the viewpoint of enhancing outreach and to obtaining professionalism and specialization to achieve a level of profitability and sustainability in microfinancing , the proposed MFB should be regarded as a step in the right direction. However, Pakistan's experience with microfinancing casts doubts about the success of the MFB in terms of both, creating credit disbursement channels and eradicating poverty. One, is the creation of the MFB simply a linear extension of the existing microcredit infrastructure? If so, then success is not certain. It is widely recognized

that the microfinancing framework in Pakistan is characterized in terms of targeting inefficiency (poorest are out), inadequacy of support (insufficient loan size), degree of uneasiness of access (problems in joining the Community Organization) and lack of self-financing (dependency on donors). Two, the existing structure ignores a very important aspect of microfinancing, the promotion of savings. Possibly the greatest challenge in microenterprise finance is to expand the provision of savings services to the poor. Access to credit by the poor has been emphasized, but research has established that the poor can also benefit from access to secure and liquid saving with adequate returns.

Microfinance strategies must be supported by a comprehensive understanding of the financial situation of poor household at the local level since the objective of microfinance is ultimately to increase household income and address basic needs. It is not clear how the MFB will coordinate with the localized NGOs and local financial intermediaries.

The banking sector in the country has a long history of poor targeting and high default rate. Political mandates may place greater emphasis on credit outflows rather than on recovery. The expansion, under the auspice of the State may lead to corrupt lending practices. Weak borrower selection criteria, little or no monitoring and pressure to subsidize interest rate are some of the factors which may reduce the success and sustainability of the MFB.

The possibility of high operating costs, including administrative expenses, may also affect the successful operation and viability of the MFB. The proposed structure of the MFB lends credence to this fear.

Recommendations

Experience worldwide suggests that the vast majority of successful microfinance institutions are private, non-government entities that run on sound business principles. Overall we suggest that government role in enhancing the capacity of existing framework should be participatory. The Government should encourage existing institutions through providing finance and technical support. Some regulation and control, however is necessary to monitor the working of existing NGOs in this field.

Nonetheless, because the Government is affirmed in establishing the MFB, the following strategy might enhance the efficacy of the initiative:

- Full Government ownership and control of the bank, in any case should be avoided.
- Complete autonomous governance, in the event government funds are invested in the bank.
- Coordination, rather than competing with or replacing present efforts in the field.
- Private sector role (investors as well as NGOs) in the MFB to the maximum extent possible.
- For sustainability and viability, pricing of products should be properly established. The MFB should recover full costs and make a reasonable return to investment.
- Finally, the Government should evaluate first the problems, flaws and procedural riddles in the existing framework of RSPs, especially in terms of targeting the poor.

THE MICROCREDIT BANK AND POVERTY REDUCTION: SOME POLICY ISSUES

By
Hari Ram Lohano

The Finance Minster in the budget speech has announced that the microcredit bank for the poor will be established very shortly. The announcement is in line with the seven point agenda of the Chief Executive. The first loan of the bank is to be released on August 14, 2000. The main purpose of the proposed bank is to reduce poverty, particularly rural poverty. The announcement was expected. Since the finance minister has taken the portfolio, he has been emphasizing the role of microcredit in poverty reduction in the country.

It is well documented that the poor lack access to credit from financial institutions. The main reason for this is that the poor lack the collateral conventionally demanded by formal banks. Since the poor do not possess physical assets, they are unable to provide the collateral necessary to get credit, and credit remains inaccessible to most. Furthermore, the provision of credit to the poor is considered a high risk given the general "established impression" that the default rate for the poor is very high. Finally, the high cost of lending to the poor must be considered feasible for the formal banking system to process a large number of small-sized loans to the poor. Since these would involve a number of resources at the institutions, this could result in high transaction costs.

The main rationale of the government in establishing the microcredit bank is to improve access to credit by the poor. There are two strong arguments for the establishment of the bank. Firstly, the growth of credit has been very slow to the poor in the country. It is particularly slow when compared with other South Asian countries in the region.

A main reason for this limited coverage is the capacity of micro finance institutions to retail credit adequately. Secondly, microcredit is one component in a basket of activities of a majority of the non-governmental organizations (NGO's). These NGO's, in addition to providing microcredit, are also engaged in many other social development activities. Therefore, they are

unable to develop the necessary specialization to be able to achieve a level of profitability and sustainability in the country.

Government's strategy regarding the establishment of the bank, according to circulated documents, is that the proposed microcredit bank for poor (MCBP) will be registered as a banking company under the Banking Companies Ordinance, 1982. The initial amount to run the bank would be Rs. 1 billion as a paid up capital. It is proposed that the MCBP will takeover the micro-finance operations of the participating regional and rural support programs (RSP's). The strategy is to buy-out the loan portfolio, staff and facilities of the existing RSP's. These will be a major shareholder. They may tap into their endowment funds for their equity contributions. Shares would be offered to commercial banks and others. The estimation is that the bank will start with existing 65,000 borrowers with an outstanding loan portfolio of Rs. 800 million. Each year 80,000 borrowers would be added. After seven years, the projection is that the program will have reached 615,000 borrowers in 53 districts of the country. The estimated amount of loan outstanding would be Rs. 9,500 million.

Microcredit plays a vital role in economic development and poverty reduction and there is no doubt about its effectiveness in poverty reduction. However, keeping in view the resource constraints at the domestic level and uncertainty of external funding, there are some concerns regarding the organizational structure of the MCBP; financial and economic sustainability; and targeting efficiency for the identification of the poor. The concern becomes more serious when there is no allocation of money or mention of foreign assistance for the MCBP in the budgetary documents. At the same time there is no clarity about the government's financial policy for the proposed bank regarding whether it will adopt traditional financial policy or a new approach for the microcredit bank.

The Traditional Approach for the Microcredit Bank

Governments throughout the world have intervened extensively in financial markets in general, and rural financial markets in particular. The extent of intervention has varied across countries. Traditionally, the case for subsidized credit is based on the following arguments: governments should focus on credit to promote rural and other development; farmers need cheap credit to

encourage them to adopt modern technology and to compensate them for policies that are biased in favor of urban dwellers; farmers are too poor to save; and private banks provide too little or no credit to poor farmers, forcing small borrowers to use moneylenders who charge usurious interest rates. Donors extended, until 1992, $16.5 billion in agricultural credit.

These programs generally have a limited outreach and huge cost worldwide including Pakistan, with little identifiable impact on the income level and poverty reduction. Elsewhere government sponsored credit programs and institutions from Peru to Indonesia have collapsed due to huge losses by traditionally directed credit strategies.

The excessive focus on disbursing cheap credit has typically resulted in programs with a poor credit culture, manifested by a dependency on subsidies, low recovery rates, mis-targeting of credit and rent-seeking by credit officials and influential personnel at different levels. The Youth Investment Program; Yellow Cab Schemes and cooperative financing are some examples regarding this category in the country.

The New Financial Approach for the Microcredit Bank

The new approach mainly focuses on income expansion and poverty reduction through the alternative cost-effective policy options, such as increased investment in infrastructure and in human development. Its main emphasis is that governments should concentrate on establishing a favorable institutional environment that facilitates the smooth functioning of rural financial markets while playing a more limited and efficient role in the direct provision of rural financial services. The main factors that cause rural financial markets to operate inefficiently can be characterized as weakly regulated financial sectors, poor institutional features (legal and regulatory), and specific constraints related to inter-mediation in rural area.

Creating a conducive institutional environment

The initial strategy to create such environment for increasing rural income and reducing poverty is the evaluation of macroeconomic policies, assessment of markets, particularly rural financial markets, and the causes of market inefficiencies or causes for imperfect information in the rural areas (see figure).

The government can promote the financial market by improving and strengthening its supervisory and regulatory role, deregulating interest rates, and relaxing credit controls. Government can also adjust regulatory framework to facilitate operations in rural areas by community-based, deposit taking intermediaries.

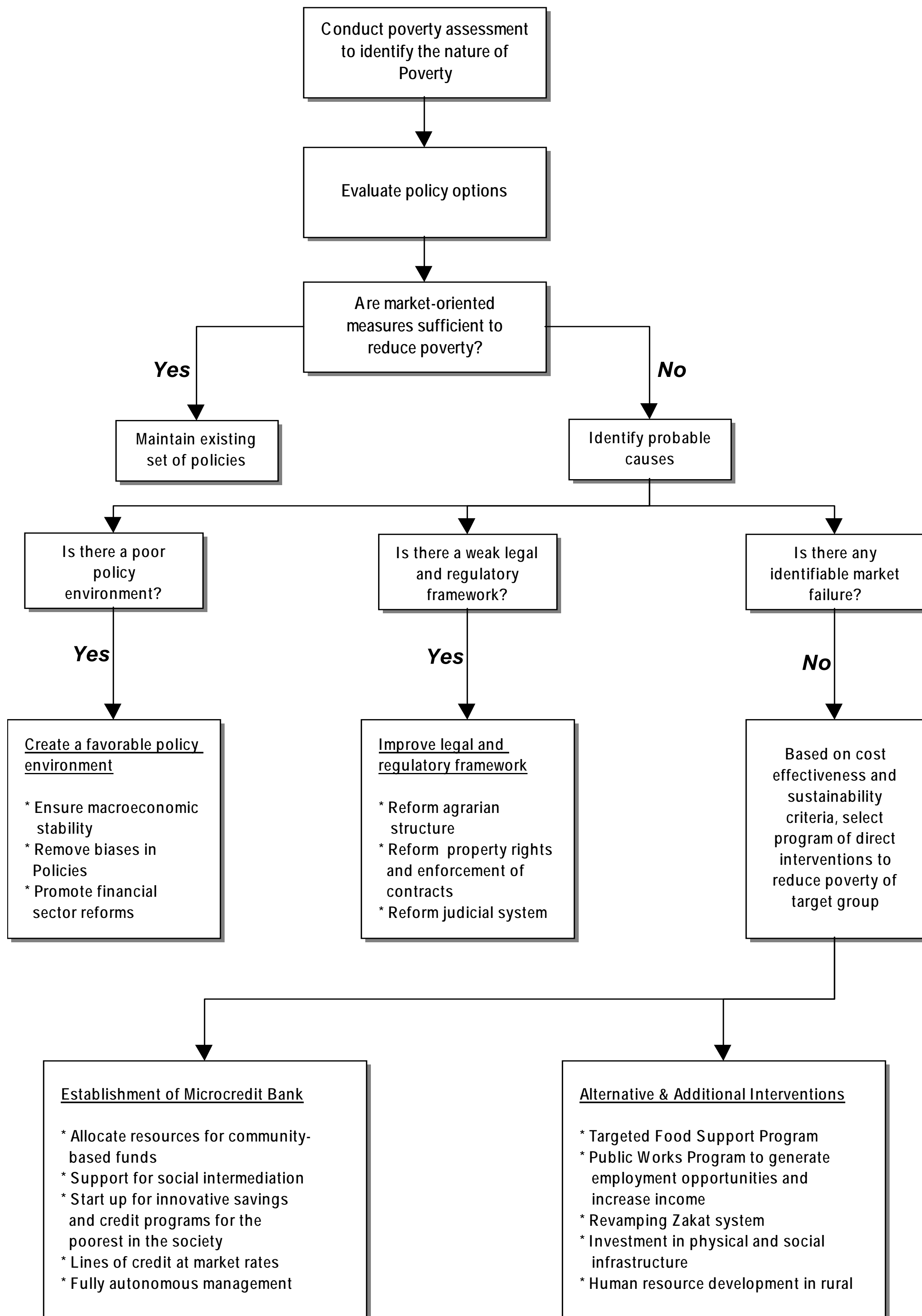
The legal and regulatory framework

Often institutional foundations for financial markets are absent in rural areas. In many developing countries, including Pakistan, deficiency in laws, regulations, and institutions prevent the formal sector from delivering credit to small farmers, rural business or even nonbank creditors, typically traders, who have many advantages in efficiently reaching poor borrowers.

It is necessary to change the existing laws and regulations to expand access to credit in rural areas, particularly provision for peasant farmers and sharecroppers; reforming the law of collateral; expanding the scope for private operations, drafting special, specific, clear and limited homestead provisions; and removing the interest rate ceiling. The costs of implementing such legal reform programs are usually low.

What role should government play in this approach for developing the microcredit bank? The first and foremost response is that the government should create an environment conducive to the effective workings of market so those private participants can allocate resources efficiently in response to price and profits. There could be a case of market failure due to many reasons, including externalities, incomplete information, monopoly etc. (see figure).

Objective: Poverty Reduction through Microcredit Bank



Rural financial markets in many developing countries, including Pakistan, generally have these shortcomings. One thing, however, should be very clear, government intervention is not the solution to a market failure.

Policy and regular reforms that promote economic growth are often the most promising way to reduce poverty, and special interventions are justified based on social norms rather than on market failures. Interventions in rural financial markets, however, are still warranted only if they are the most cost-effective means of reducing poverty.

The government's intervention into the financial market should aim to remove the causes of market failure and reduce poverty, using the most appropriate mix of instruments. For instance, funding for a pilot program, institutions, like private financial intermediaries, NGO's, and establishment of a microcredit bank.

Interventions should be designed to complement, facilitate, or improve the financial market over the long run. The government should not later prop up its MCBP/rural financial institutions with more favorable access to subsidies or consessional funds than are available to entrepreneurs. On the contrary, competition should be encouraged. Subsidies should be restricted for only the poorest among the poor. The cost of the program to develop the microcredit bank should be monitored to assess the cost-effectiveness of the interventions.

There are plenty of failures among the state-owned specialized rural credit institutions in the world. The main reason is lack of governance, incapable management, political and financial intervention, and lack of innovative and efficient operating procedures. They have not addressed the real constraints and have been plagued by incentive problems.

Even worse, the rich have frequently captured the subsidies, compounding problems of poverty and inequality. The majority of loans by ADBP and Cooperative societies come under this category in the country. If the opportunity cost of resources, opportunities by private rural financial institutions and fiscal costs of propping up loss-making is taken into account, the

economic costs are likely to have far outweighed the benefits of these public-sector institutions. Nevertheless there are some successful examples in the provision of microcredit to poor.

The leading Asian financial institutions which are considered successful examples in the provision of microcredit are the Bank for Agriculture and Agricultural Cooperatives in Thailand; Bank Rakyat Indonesia (BRI- UD) and the Grameen Bank in Bangladesh. These successful examples contrast sharply with the traditional view that heavy subsidies are inevitable in the provision of financial services to rural entrepreneurs.

The main reasons for their success are:

- A high degree of management autonomy in formulating operational policies.
- Staff accountability, investment in human capital, and rewards for sound financial performance and sustainability
- Innovative, low-cost delivery mechanism and mobile banking services
- Innovative and flexible loan terms and conditions adapted according to the social, economic and cultural circumstances of the communities. For instance, repayment schedule is tailored to income flow of the client.
- Regular monitoring of loan utilization and performance; high and timely recovery rate and low rate for default and loan losses
- Development of domestic savings accounts to reduce dependence on donor funds
- Control over administrative expenses and effective use of economies of scale.
- Advanced management information systems that facilitate effective planning, control and timely monitoring of loan repayments.

In light of the above, it can be suggested that to establish the microcredit bank the government should meet the following strict governance criteria:

- Fully autonomous management that is held responsible and accountable for the bank's financial performance
- Exemption from civil service pay scales to attract and reward quality staff on the basis of the institution's financial performance

- Autonomy in determining the borrowing and lending rates that apply to commercial banks, so that deposit and lending are at market rates
- The development of a strong management information system through the application of international best practice prudential regulatory, accounting, and disclosure practices.
- Both off-site supervision and on-site examinations by independent and professional agencies
- A hard budget constraint
- A clear strategy to develop MCBP is supported only with initial, nonexclusive, time-bound, transparently budgeted subsidies.

Conclusion

The government's announcement in the budget to establish micro credit bank is a good decision for poverty reduction in the country. To improve its access to the poor and avoid the leakage of funds to the non-poor, its organizational structure and institutional environment should be based on the new financial approach which reduces direct intervention by government and improves the financial and economic sustainability of the proposed bank to reduce poverty in the country.

PRO-POOR PUBLIC WORKS PROGRAM: IS THAT A NEW PROMISE?

By
Haroon Jamal

The Public Works Program has been an important counter-cyclical intervention in developed and developing countries. The program was used in some western countries during the years of the depression in the 1930s. More recently, several developing countries in Asia, Africa and Latin America have adopted the program in some form or another. Unfortunately, the world's experience reveals that many plans were no more than vaguely formulated strategies. Only a minority of countries have genuine action plans – with explicit targets, adequate budgets and effective organizations. Many countries do not have explicit action plans but incorporate anti-poverty measures into national planning and budgeting. And many of these then appear to forget the topic. Let's hope that the present Government's efforts towards poverty reduction will be successful.

Government Strategy

The Government has launched the Integrated Small Public Works Program (ISPWP). An allocation of Rs. 21.2 billion has been reserved in the Federal Budget 2000-01 as against Rs. 3.5 billion in last year's budget. According to the Finance Minister, this is a district level initiative, under the guidance of provincial governments, which would create employment and income augmenting opportunities for the rural and urban populations, besides improving their living conditions. The Army Monitoring System will act as a third party audit to ensure maximum and efficient utilization of funds. Local community will also be involved in the identification of schemes to be funded under the program. Furthermore, a targeting mechanism has been evolved, that will allow greater application of funds to areas facing extreme backwardness. In the next financial year, provinces will receive Rs. 18 billion for poverty reducing projects and programs. The share of each district shall be determined by the provincial government itself, keeping in view the relative poverty of the districts. However, the distribution among the provinces is neither stated nor yet documented.

The Budget Mechanics

An overall Public Sector Development Program (PSDP) of Rs. 120.5 billion with a foreign aid component of Rs. 41.6 billion has been fixed for next year. It represents 3.5 percent of the GDP and is 4 per cent higher then the PSDP of the previous year. Table 1 below depicts the changes in the major components of the PSDP allocations.

TABLE 1
PUBLIC SECTOR DEVELOPMENT PROGRAM

(Billion Rupees)

Classification	Budget Allocations		Shares in Total PSPD (%)		Changes (%)
	1999-2000	2000-2001	1999-2000	2000-2001	
Federal Ministries	45.2	39.6	39	33	- 12
Corporations	38.7	30.5	33	25	- 21
Special Programs	3.6	5.6	3	5	56
Provincial Programs	28.8	44.7	25	37	55
Total	116.3	120.4	100	100	4

A detailed scrutiny of sectoral programs however, reveals that in certain sectors allocations are drastically reduced. Table 2 furnishes this information. The table reveals that the deductions are made in Federal programs. The transfer of funds from the federal to the provincial level is certainly a step in the right direction. The move should be welcomed because line ministries run sectoral programs, while targeted programs are run by provinces.

TABLE 2
SECTORAL CUTS IN PSDP

(Billion Rupees)

	1999-2000	2000-2001	Difference
Physical Planning and Housing	3.184	1.736	1.448
Rural Development	10.537	2.419	8.118
Tameer-e-Watan	3.000	0	3.000
Tameer-e-Sindh	0.500	0	0.500
Village Electrification	7.500	0.500	7.000
OGCD	0.096	0	0,096
National Highway Authority	19.100	15.000	4.100
Total	43.917	19.655	24.262

Issues Unresolved

It is insufficient though, to simply allocate or transfer funds to provinces for poverty alleviation programs. It must not be a routine Government exercise of approving projects and allocating funds. A lot of preparatory work is required before implementing a public works program. There are various questions that, at this point, are still unanswered. These include:

- *Targeting:* How can public spending assist those who have been left behind by economic growth. The question of targeting poor provinces, districts and communities is the first and major issue for the allocation of funds. The mechanism should be clearly elaborated.
- *Delivery Mechanism:* There are three basic types of delivery mechanisms used to carry out public works in developing countries. These are: force account (public agencies supervise, manage, and control machines and labor), or through registered and pre-qualified contractors or small local contractors. Choosing a delivery mechanism for targeted programs is important for cost effectiveness, financial management and wage determination. The level of wage rate is critical in determining the distribution of benefits from the program, as well as how much of the program is targeted toward the poor. The question of what mechanism should be adopted considering the level of corruption, weak governance and political maneuvering of public funds, is a pressing one.
- *Political Economy of Transfers and Targeting:* The issue of decentralization and devolution of power is critical in effective implementation of public works programs. Who will decide the type and area of programs? At what level will priorities be determined? Who will supervise and control the programs?

Followings are some recommendations in terms of targeting, project design and effective control, to realize the potential of Government anti-poverty interventions:

- A credible 'poverty-map' should be prepared for rationing the allocated funds among provinces and districts.
- The labor intensity (share of wage bill in total cost) should be as high as possible.
- Public works in rural areas should be synchronized to the timing of slack agricultural seasons in the particular area.
- Transaction costs to the poor should be kept low (locating project sites close to the village or urban locality).
- It is necessary to ensure appropriate mediation of community based NGOs for protecting the rights of the poor. Their participation may also facilitate the project monitoring.

THE QUESTION REMAINS - POVERTY ALLEVIATION THROUGH FOOD STAMPS?

By
Sehar Rizvi

Food Subsidies

Food subsidies, whether they are in the form of open general subsidies, quantity rationing or food stamps, are a common method of attempting to reduce food insecurity, although, due to of fiscal constraints they have become less popular in recent years, with greater emphasis placed on employment and productivity-raising interventions.

A general, untargeted subsidy is provided by food rations where the subsidised commodities are restricted in quantity but not in coverage, and by the untargeted issue of food stamps or coupons. Their advantages reside in the relative simplicity of general or non-discriminatory policies, and the limited demands on administrative resources. The main disadvantage lies in their inefficiency, since all groups benefit, not only those targeted by government objectives.

Food Support Programme

As part of the Poverty Alleviation Progamme, the government is initiating a Food Support Programme (FSP) through which three basic commodities, wheat (flour), edible oil and sugar, will be provided to the poor. The FSP is considered to be a 'calorie intake based approach' targeting those who have no access even to basic subsistence levels. The federal budget for the fiscal year 2000-01 has granted a sum of Rs 2500 million to this programme. This is the first instance where an individual grant has been allocated to the food stamp programme, as previously it was administered through the Bait ul Maal. The programme meant to go nationwide by July was initially designed to mitigate the impact of adjustment in the wheat support price; on a more macro level, it is meant to insulate the poorest segments of the population from the adverse effects of economic adjustment.

The Federal Government will administer the programme. Three different committees, the district food support committee, Zakat committee and army committee, guarantee operation of this programme through monitoring at the district level. Scant details have been provided as to who will comprise these monitoring committees and more so as to how they will function in a ‘local

government environment' which has yet to be implemented, let alone meet with any success. It has been proposed that Post offices and Bait ul Maal will be used to disburse the funds to the identified families. A district food support committee under the direction of the deputy commissioner shall identify eligible households from the rural as well as urban areas.

Target groups of the programme are households whose income is Rs 2000 per month or less. Government employees and those engaged with autonomous organisations are not included in this scheme. Furthermore, those households who are receiving the 'Guzara allowance' from the Zakat Fund are not eligible for this programme.

Evaluation

The Food Support Programme is one of the four pronged approaches to alleviate poverty. The government claims that the programme will cover about 1.2 million of the poorest households. This is not a small number by any means. However, research at SPDC reveals that currently 31 per cent of the population is below the poverty line[1]. If long term poverty alleviation was the foremost aim of the programme, and if the programme was well targeted, any programme that aims to benefit over two million people is not to be termed completely worthless. But these ifs have to be kept in mind when talking of this programme.

Established in 1992, the Pakistan Bait-ul-Maal provided the benefits of the Food Subsidy Scheme (FSS) renamed the Atta Subsidy Scheme. Until 1994, the Bait-ul-Maal ran a food stamp scheme, now abandoned, which benefited 4.2 million people. Its limited coverage is one of its main problems. With only 240,000 people receiving the Atta subsidy[2], it is quite clear that interventions from the Bait-ul-Maal only make a minor dent on poverty in Pakistan. Further, given that it has no identifiable source of income, its exclusive reliance on budgetary support makes it particularly vulnerable to changing fiscal conditions as can be seen from the steep fall in grants from Rs 296.7 million in 1998-99 to Rs 225 million in 1999-2000[3].

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[1] *Ghaus-Pasha, A & Jamal, H. 2000. Incidence of Poverty in Pakistan. Social Policy and Development Centre, Karachi.*
[2] SPDC. 1999. Social Development in Pakistan. Annual Review. Oxford University Press, Karachi.
[3] *Government of Pakistan. Federal Budgets. Various Issues.*

A food stamp programme has been previously implemented in the Punjab, targeted towards food stamps to buy atta (flour). The scheme could have been broader to allow milk purchases for children or vegetable purchase, etc. This lack of variation indicated that there had been no study on what a balanced diet requirement is and, therefore, what the government should be funding. Initially the government was allowing up to 3 stamps to a six-member family so that they could buy up to 60 kilograms of atta. But this was reduced to 2 stamps for 20 kilograms of atta. Atta support might not be enough for a balanced diet. However, if even atta support was reduced, then the obvious impact on poverty alleviation was to be much lower. It has been indicated that calorie based poverty in 1998-99 was 32.6 per cent[4].

The methods for the selection of beneficiaries in this food support programme are not clear. It is well known that officials, political functionaries and the local elite often capture public subsidies. The main issue in the success of this programme, therefore, is likely to be the effectiveness with which they are implemented. A mechanism is needed to ensure that there is no overlap with receipt of Zakat payments.

Problems posed by targeting on the basis of income through the issue of food stamps or coupons arise from the database from which they are administered. In most low-income countries, information on household income will be scarce or non-existent, making it difficult to locate the target recipients. The problem is compounded over time, as households move both physically, thus creating the danger of being lost to the administering authorities, and in and out of income brackets. There is a danger under these circumstances, of the numbers involved becoming cumulative. Efficient and persistent monitoring is necessary for the success of any coupon system, not only for initial recipient identification, but also because the poorest households are often among the most itinerant.

Institutional arrangements must be strengthened for identification of eligible persons in the FSP. A problem with targeted programmes is that they are notoriously hard to restrict to the target population. The poorest sections of the population are the ones least connected with the formal government structures. In most cases they do not have National Identity Cards or domicile

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[4] *Government of Pakistan. 2000. Economic Survey.*

certificates. They are likely to be the ones who do not have settled places of residence; and yet they are expected to open accounts with the post offices of their respective areas where their share of money will be deposited every quarter.

Targeting Mechanisms and Efficiency

The mechanisms used to identify the poor can be classified according to three broad categories of individuals, geographic and self targeting. An example of geographic targeting would be through the location of ration shops or distribution centres in poor districts. This is in effect a form of self-targeting by location. This has the advantage of administrative simplicity, although a degree of leakage is inevitable and accepted. An alternative mechanism of self targeting is by commodity; most empirical studies of consumption patterns confirm that lower income groups tend to consume a higher proportion of foods perceived as 'poor people's foods', and that their income elasticity of demand for such foods is relatively high compared with other income groups.

An example of an individual assessment is a means test that ascertains whether household income is below the cut off point. The test uses either income, nutritional status, or type of dwelling (with or without electricity etc) as a criterion. If it was possible to conduct a 'perfect' means test, cash transfers dominate other forms of interventions because they carry only an income effect and do not distort private consumption decisions at the margin.

But because of the informational and administrative constraints, means testing may not be perfect, and may induce costly leakages and create adverse incentives. Antyodaya Programme in Rajasthan, India provides an interesting counter example of a successful means test based on community identification, where the village elders decide which are the poorest families in the village.

Whether a programme reaches the poor depends on how effectively the programme is targeted. Generally, the proportion of leakage is higher under price subsidies and quantity rationing,

modest under food stamps[5] and lowest under programmes involving food with work requirements.

Recommendations

Food stamps may enhance welfare more than price subsidies or quantity rations. They are the least distortionary programme in that they allow the consumer the widest choice of commodities. But in some countries wider consumer choice may perpetrate intra-household discrimination. Food stamps allow adults to make food choices that may not raise children's welfare. Thus quantity rations on food staples with high transaction costs might be more beneficial to children than food stamps.

Changes in character or coverage of programmes over time have been driven by fiscal tightness. In Sri Lanka, the universal ration programme in operation prior to 1979 cost the government up to 5 per cent of GDP. The unsustainably high cost drove the government to institute a food stamps programme. The move cut costs to 1.3 per cent of GDP. But the programme in Sri Lanka could be better targeted, and its costs could be further reduced; nearly half of the country's population had access to food stamps, whereas the incidence of poverty was less than 30 per cent[6].

Targeted nutrition programmes backed by nutritional education and growth monitoring have been highly cost effective in combating malnutrition. India's Tamil Nadu Integrated Nutrition Project programme confirms this finding; mothers who brought their first child into the programme and who were given "nutrition education" absorbed the lessons. This result was evident in that they brought their second child and subsequent children into the programme. In food stamps and nutrition programmes design appears to be crucial for targeting and cost effectiveness. Thus clinic-based programmes that combine health inputs with nutrition supplements operate with lower administrative costs than school based programmes. But school-feeding programmes may achieve other objectives, such as promoting school enrollments,

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[5] In most voucher and stamp schemes leakage is low. But vouchers and stamps are tradable and the real test is how much of their value reaches the poor.

[6] Subbarao, K. 1997. Safety Net Programmes and Poverty reduction. World Bank, Washington, D.C.

particularly of girls. If this is the case then school-feeding programmes should be assessed not as nutrition interventions but as programmes meant to realise other social objectives.

Direct targeting mechanisms must be strengthened, possibly replicating World Food Programme (WFP) for lactating mothers and schoolgirls. The WFP oil incentive in Pakistan encouraged more expectant mothers to use the existing facilities at health centers. It was observed that the daily registration and examination of expectant mothers in the assisted centers (where oil was distributed) had increased on average by 71 per cent.[7]

In Honduras, the value of the daily family food ration in food for work activities is approximately 80 per cent of the national minimum wage. This is used as an incentive for mothers to regularly attend rural health centers for pre and postnatal care, and to have their children's growth monitored. The identification of beneficiaries, distribution of family rations and monitoring of nutritional progress of beneficiaries is carried out by the community council with the participation of a committee formed by women beneficiaries. If the beneficiaries fail to show atleast 50 per cent of the targeted expected outputs (rising trend in the weight for age after one year) the ration programme is phased out.[8]

Further food transfer distribution could be linked to social services primarily used by the poor where the level of leakage is low. Transfer schemes (eg.school feeding programmes and supplementary feeding to target groups such as pregnant or lactating women) are less ambitious in their scope but when funds are limited they can prove highly effective in improving household food security. Their success depends on their limited objectives and their ability to employ existing administrative structures. An example of the latter is the use of health centers, for which the process brings secondary advantages in the form of encouraging higher attendance.

In the last decade inequality has increased in Pakistan. The government has employed various tactics, but the poor have been the least effected. The government does need to make poverty alleviation a priority, and food stamps can be one way. But as the programme stands today, it is

[7] *WFP. 1996. Project Pakistan 223. Progress Reports. http//www.wfp.org*
[8] *WFP. 1997. Project Honduras 5691. Progress Reports.*

too small and too shallow (as it covers only flour). The government is giving a person a sum of Rs 167.67 per month extra as a poverty alleviation tool. Clearly this is inadequate. It is not well targeted and is allowing plenty of scope for abuse. Food stamps programmes not only help in reducing hunger, but they are also supposed to help increase the work capacity of individuals by removing calorie deficiencies. In the case of the government's Food Support Programme, it is not giving enough support to individuals to really allow them to come above the poverty line, and it does not offer them enough variety to really remove calorie deficiencies.

ZAKAT AND USHR IN THE FEDERAL BUDGET 2000-2001

By
Sumaira Jafarey

The budget 2000-01 has outlined four main components of the government's poverty alleviation package. While the public works component is well defined, the food stamps scheme has been cursorily outlined and utterances on the proposed Micro Credit Bank are vague. The final component of the government's strategy is the system of Zakat and Ushr. There was much speculation after the Chief Executive's December announcement of an economic plan, that the Zakat and Ushr system would be overhauled, or at least reviewed. The announcement of an increase in the amount of the Guzara Allowance from Rs.300 to Rs.500 a month is the only measure announced in the federal budget on the issue of Zakat.

Funding

Zakat and Ushr funds are not part of the federal budget. They are collected by the State Bank and put into the capital account of the government of Pakistan; they are not, therefore, part of the government's Rs. 21 billion poverty alleviation fund. The source of funding of Zakat is independent of the government's budget and this aspect serves well as a safety net in a resource strapped economy where social sector outlays come under pressure from budgetary constraints. However, a recent Supreme Court Judgement cast the sustainability of Zakat funding in doubt by ruling that it was no longer compulsory for Sunni Muslims to pay Zakat on a range of financial instruments. The subsequent Zakat deduction date, however, did not show a massive fall in the amounts of Zakat collected, instead the total amount is believed to be even higher than last year. The reason for this was that there was massive confusion surrounding the procedure for claiming exemption from the State Bank, which is done by filling out a necessary form. The form had to be submitted 30 days before the deduction date, a fact which many were not aware of. Nevertheless, can we reasonably expect Zakat funds to decrease next year as more people gain exemption from compulsory payments? The answer is uncertain as the federal government will appeal the Supreme Court's judgement in the Federal Shariat Court. If the appeal is not upheld, then serious concerns will arise regarding the fiscal sustainability of the Zakat scheme with no explicit budgetary support and the fact that funds collected for Zakat have registered

only small increases in the last decade (partly due to increased contribution form savings accounts etc.) will the funding structure be able to accommodate the increase in Guzara Allowances (from Rs.300 to Rs.500)? Given the current coverage this implies an additional liability of Rs.2.6 billion per annum. In the absence of increased government fiscal commitment, an unfortunate consequence of the increase in the amount of Guzara payments, given existing funds, may be a reduction in the coverage of the Mustahiqeen on the Guzara Allowance, which is already low with 1.1 million households benefiting form this payment.

The System of Zakat

The Zakat funds which the federal authorities disburse to the provincial Zakat departments are earmarked for a variety of benefits, the most important of which is the Guzara or Subsistence Allowance. According to the official figures, at present there are 1.1 million *Mustahiqeen* spread over the country who are benefiting from the Guzara Allowance. The *Mustahiqeen* or needy persons who will benefit from the *Guzara* Allowance are widows, the disabled and orphans. A study conducted in two *katchi abadis* by us at SPDC shows that not more than about 17 people in communities with a population of 50,000 benefit from the *Guzara* Allowance. This would reinforce results from other studies of the overall system, that coverage is low.

The disbursement of *Zakat* takes place through a tiered system starting at the federal level, followed by the provincial , the district and finally the local level. There are approximately 39,000 Local Zakat Committees (LZCs). Distribution of funds by the provincial Zakat council is formula driven, with 60% going to local Zakat committees and 40% to institutions (deeni madaris, public hospitals, vocational training institutions, etc.).

Concerns with the System

The Local Zakat Committee (LZC) is responsible for disbursing funds it receives from the District Zakat Committee. While the selection of the beneficiaries is done by the LZC, the limit on beneficiaries of Guzara Allowance, who tend to be mainly widows, is set by the District Committee. Monitoring by the District Committees is irregular which leaves us with the question, how can a committee set the number of beneficiaries from above without knowing the extent of poverty in a community? Furthermore, the funds from the District Committee suffer

from irregular disbursement, hence at times, delays of up to 6 months occur in the disbursement of the Guzara Allowance to recipients. As the Guzara Allowance is an income support payment to the poor, especially targeting those without a regular source of livelihood or those unable to work, the delays in disbursement are a serious shortcoming of the system as the poor cannot plan their expenditures to ensure consumption smoothing.

As far as the adequacy of support of the payment is concerned, while Rs. 500 for a person whose income is Rs.2000-2500 may seem reasonable, it does not fare too well when one takes into account the number of dependents a household has. A widow with two children is much better off on such a payment, than one with six. This calls for the government to consider giving each additional dependent an income supplement and correspondingly reducing the payment itself. A fundamental concern expressed by some observers is that Guzara Allowance only results in the creation of dependency amongst the recipients thus reducing them to the level of beggars. It would be far better, in their opinion, if the government used the money to set up income generating projects for the Mustahiqeen, as they feel that even the disabled can do certain types of work.

An alternate to this suggestion would be to increase the number of people on the Rehabilitation Allowance(very limited coverage currently) thereby making them autonomous and able to earn their own income. One year's Guzara Allowance would come to Rs. 3600 while a one off Rehabilitation Allowance is Rs. 5000. However, some people, such as the severely ill and the old, would not be able to utilize the Rehabilitation Allowance to set up a business. Also, certain activities require the person to learn skills, e.g. embroidery, which may cause further problems to the poor in terms of earnings forgone and money spent learning these skills.

There is a clear need for better monitoring of the Zakat process. Monitoring should be done on a regular basis at set times, both in the form of regular checking of the records as well as audit teams actually visiting the locality itself. This will improve transparency of the process, making the local authorities more accountable even though administrative costs would rise. Targeting may be improved as a result of District officials verifying the poverty profile of the community thus reducing leakages.

There is need for serious attention to be given by the government to the issue of delays in disbursement. This is a critical issue as irregularity of the Zakat payments imply that the poor cannot depend on Zakat as a regular source of income and therefore cannot plan their expenditures in advance.

Recommendations

The government should undertake a study to see how the Guzara Allowance has fared as a poverty alleviating mechanism. It should be contrasted with other benefits offered under the Zakat system to assess its efficacy especially as 60% of Zakat funds are allocated for this purpose.

A new order issued by the District East Zakat Office of Karachi states that shortly, Zakat cheques will be handed out in open *kutcheris*. This is a matter for serious concern as it means that not only will Zakat become politicized, but also that the anonymity of the recipients will be jeopardized. The government should note the implications of this move.

Based on our empirical work we also noticed that there are differences in the directives issued by the District East and District West Offices. The differing specifications regarding education could be due to differences in literacy amongst communities. However there are other discrepancies such as the lack of female committee members (as stipulated by law) in some localities and the discrepancies in amounts for education allowances. Directives that reflect some measure of uniformity should be issued.

The concept of relative poverty should be explored further as poverty differs from community to community. How are the quotas set by the District Offices for the Guzara lists? Are the needs of really poor localities being ignored at the expense of covering the maximum level of communities when some of these communities may be uniformly better off than others?

To sum up, there needs to be a major review of the Zakat and Ushr system which suffers from low coverage, targeting problems, low ease of access and low impact on development. While the

increase in the Guzara payment from Rs. 300 to Rs.500 is a step in the right direction it will only work in the overall context of a more efficient and transparent system.

FEDERAL BUDGET: FROM PRO-WOMEN SLOGANS TO ANTI-WOMEN ACTS

By
Dr. Aisha Ghaus-Pasha
Sehar Rizvi

Pakistan's GDP growth of almost 4 per cent in recent years has not translated into welfare and productivity gains for its female citizens in particular. The mortality rate for girls in 1998 was 37 per thousand births while the adolescent fertility rate (births per 1000 women aged 15-19) was 102 in 1998. Female literacy was 29 per cent and a combined first, second and third-level gross enrollment ratio stood at 28 per cent and 56 per cent for females and males respectively[1]. Further, the sex ratio in Pakistan is 105.8 males per 100 females[2]. South Asia is the only region in the world where men outnumber women. From cradle to grave, there is a record of preferential treatment for boys, in provision of food, nutrition, health care, education, and other facilities.

The Federal Budget 2000 has seen a reduction in the Public Sector Development Programme allocation for the Women Development sector. The priority attached to women development is evident from the decrease from Rs 50 million (1999-2000) to Rs 46.7 million (2000-01) which will in turn have an impact on gender specific programmes. The thrust of the government's policy over the years was to improve educational status, expand health facilities and provide more openings for income generation. In addition, "removal of discrimination in education and employment, and better information and communication of women's issues, on their rights and responsibilities" was to be ensured[3]. Thus, it appeared that the stage was set for positive policy for women to emerge. The budget, however, fails to live up to the 'image' created.

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[1]*IBRD. 2000. World Development Indicators. The World Bank, Washington, D.C; UNDP. 1999. Human Development Report 1999. Oxford University Press, New York.*
[2]*ADB. 1993. Gender Indicators of Developing Asian and Pacific Countries. Asian Development Bank, Philippines.*
[3]*Planning Commission. 1994. Eight Five Year Plan 1993-98. Government of Pakistan, Islamabad.*

In income tax measures, liability for working women is now at par with males. The taxable income threshold of Rs 60,000 per annum in case of salaried working women has now been deleted by an obscure clause inserted by the Finance Ordinance, 2000. The threshold limit for all salaried assesses, irrespective of gender is now Rs 50,000. Inequalities in access to and control over resources, and entry into the labour markets already exist and hamper women from taking advantage of reform. This tax amendment will further exacerbate the situation, as women will be increasingly discouraged to enter the formal sector, thereby creating a loss of labour power for the country, but more importantly, a loss of much needed revenue for women. The justification for the higher exemption limit was the higher cost of child care for working mothers. Apparently, this justification has not found favoaur with our present fiscal policy makers.

A reduction in SAP tied allocations of about Rs 5,700 million will adversely affect women, since this will result in decreased spending on health and education, two areas where a gender gap exists. Negative impacts on child health also affects women, whose role it is to look after the sick. Similarly, another impact of cutting down on the number of teachers employed is that it will disproportionately affect women compared to men. The primary education gender gap remains significant and the construction of fewer schools will cause girls to suffer. A profound relationship has been established between investment in female education and lower rates of infant mortality and fertility. Since basic needs are interdependent and the education of women provides major positive externalities, the case emerges for emphasizing female literacy.

SAP acknowledged that the success in the social sectors required a clear sense of priorities; infact it was indicated that female education and family planning were the “key inputs” because of their causal linkages with other aspects of socio-economic development[4]. This only goes to show that women play a key role in SAP as target beneficiaries of increased literacy, family planning, nutrition, primary health care, and rural water and sanitation programmes. The school participation of girls is 62 per cent whereas for boys it is 92 per cent[5]. The major bottlenecks to formal education are lack of schools for girls, reluctance on the part of female teachers to work

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[4]*Planning Commission. 1992. Social Action Programme 1992-1995. Government of Pakistan, Islamabad.*
[5]*Government of Pakistan. 2000. Economic Survey 1999-2000. Finance Division, Islamabad.*

in isolated rural areas, etc. SAP envisaged the introduction of 60 per cent girls' schools and an increased employment of female teachers through stipends.

Health and Nutrition has gone up slightly showing an increase of Rs 275 million. But it is still a disappointing amount in a country, which has one of the lowest maternal mortality rates at 340 per 100,000 live births[6]. Maternal health has important intergenerational effects. Sick, weak and uneducated mothers tend to give birth to underweight and unhealthy children who are more likely to die in childhood or remain prone to illness throughout their lives. The entire health system would be more effective if women were targeted as the link between the public health services and the home, through a health education programme. Even illiterate or semi-literate mothers, who are given some basic health education, can, in effect, become "health workers" within the family.

Reductions in water, education and training will impact negatively. Clean water is the responsibility of women who will now have to spend more time fetching clean water and tending to those who fall ill as a result of contaminated water. Since women are the primary carriers and users of water for the family, the less educated they are in the area of hygiene and sanitation, the more the whole family will continue to be subject to water borne diseases, which cause most of the illnesses in Pakistan. Such education would, of course, need to be combined with better water supplies and sanitation facilities to reap the maximum benefit, but improvements can be made even under existing circumstances. It is indeed unfortunate that a time of drought drinking water allocations have been cut, indicating the apathy of planners to extreme human conditions.

There has been an increase in rural development schemes. These will aid women if they provide infrastructure which benefits women, in the form of non-farm schemes, clean water for instance. If water supplies were more easily accessible, women would become more productive and efficient in performing their domestic responsibilities, and by having more time on their hands, could devote themselves to a more 'productive' output. Lack of time is often a primary reason

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[6]*UNDP. 1999. Human Development Report 1999. Oxford University Press, New York.*

for women's weak response to economic incentives, especially in rural areas. Therefore, the case for making public investments in infrastructure.

The government's devolution plan to the local level has placed strong emphasis on the representation of women; women are expected to contest elections and sit on equal terms in councils alongside men. At the lowest local level structures, an equal number of men and women will be elected, thereby giving the women of Pakistan a "unique opportunity to contribute". This will be a vain expectation if the fundamental problem of access to social services is being denied. The government plans on strengthening women's participation in the political arena. Is this mere rhetoric as at present they are failing to even meet basic human needs?

Turning now to the social safety nets, as Zakat is targeted mainly at widows, an increase in the Guzara Allowance as stipulated will have a positive impact on them, though the coverage is small. But the Zakat system needs fiscal sustainability, strong financial management and improved targeting system before it can develop as a major social safety net.

The Food Stamps Programme does not have a gender component. The various innovative food programmes for mothers, schoolgirls and for work in other countries combine some of the best features of social safety nets, not explicit in the programme initiated by the government. Benefits are enhanced since distribution is connected to social services. School feeding programmes promote school enrollment, particularly for girls. Food stamps for lactating mothers and schoolgirls encourage women to use health facilities. Further, public works do not employ women in Pakistan, unlike India, due to the traditional seclusion of women.

Overall, the government has not incorporated measures for gender equality into their antipoverty strategies. Targeting women directly is justifiable on two grounds. First, to the extent that gender inequalities prevent an economy from realising its full potential, targeting women can be an affective strategy for increasing productivity. Second, where gender differences are wide, targeting may be needed to capture social gains. This is especially appropriate when doing so contributes directly to reducing poverty or when women have particular needs, for example, when maternal mortality is high. The high gender gap in education enrollments can be reduced

by policies that target girls; an obvious example would be policies that affect the private costs of schooling.

The Micro Credit Bank so far has no special conditionalities regarding women. Women in Pakistan have virtually no access to formal credit, which severely limits their ability to invest in more productive activities or inputs. The usual rationalizations for denying women credit is that they do not make decisions over economic resources. The possibility of receiving credit may give women greater bargaining power within the household, which can be used to improve child health and nutrition. Welfare effects of the Grameen Bank loans have proved that female borrowing has had a greater effect on girls schooling and per capita expenditure than male borrowing. Interestingly, female borrowing has also resulted in more female ownership of non-land assets and an increased supply of female labour to cash-income-earning activities[7]. Orienting towards micro-credit is essential for a balanced approach to poverty reduction because the largest component of the poverty alleviation programme is in the form of a public works programme designed to create employment primarily for males.

The latter finding is very important because much of the wage employment open to women in rural areas is very poorly remunerated and can be quite exploitative. Self-employment can bring the opportunity of higher returns for women, plus the freedom to integrate their cash earning activities into other work, as they desire. The documentation of the informal economy could impact negatively on women as they play a large role in garments manufacturing, etc. If the profitability of the sector decreases then wages of lower income urban women could be cut back. However, if value added increases in the garment export industry, then a rise in real wages could take place for these same women. By encouraging small enterprises, as is evident with the renewed emphasis granted to SMEDA, middle class urban women may benefit by setting up small-scale ventures, for instance a garment industry.

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[7] *IBRD. 1995. Towards Gender Equality. The Role of Public Policy. World Bank, Washington, D.C.*

According to the latest World Development Indicators (2000), in Pakistan, women account for 28 per cent of the labour force, and the female economic activity rate as a percentage of the male rate is 40 per cent. Targeting infrastructure investments to the poor, which takes account of the needs of women entrepreneurs can significantly enhance their productivity and earnings. Social norms affecting decisions about occupational choices inhibits job creation in the formal sector. Thus, informal activities play a vital role. The competitiveness of this sector is constrained by women's limited mobility and lack of access to financial and public services. In a country where cultural values prevent girls from travelling alone to school, for instance, measures are needed that will increase access to safe transport and change the geographic distribution of primary schools.

Female household members tend to allocate resources more directly to children, while men tend to allocate more resources to adults. By directing public resources towards policies that reduce gender inequality, policy makers are promoting not only equality today, but also higher labour productivity, a higher rate of human capital formation, slower population growth, and stronger economic and social progress tomorrow. The Government can no longer afford not to invest in women. The evidence on social returns to investment in women and girls cannot be ignored.

However, it appears that Pakistan is caught in a policy stalemate. The severe constraints to designing and implementing a policy on women make a policy necessary, but also make any policy ineffective. Therefore, what option is available to ensure positive policy formulation for women in Pakistan? The only route lies in the responsiveness to gender gaps which can be overcome by pledging significant additional resources in the four key areas of primary education, primary health, family planning and rural water supply and sanitation. Also, targeting of women in the poverty alleviation strategy will constitute a move in the right direction. Correcting for past under-investment will require a 'gendered' approach to public policy.

GOVERNMENT'S POVERTY ALLEVIATION STRATEGY: HOW EFFECTIVE IS IT LIKELY TO BE?

By
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Concerns for poverty alleviation have been heightened by the substantial rise in the incidence of poverty in recent years. As much as one-third of the country's population (almost 45 million people) are unable to generate income sufficient to provide minimum nutrition and other basic necessities of life, that is, they are below the poverty line. The number of the poor is higher in the rural areas (32 million) than the urban areas (13 million) but the worrying thing is that the latter is rising more rapidly. This implies that even though rural poverty is a bigger problem today, urban poverty is fast catching up. Rightly so, the government is making attempts to tackle the problem. The crucial question is: Is it doing enough to have an impact?

The budget 2000-01 has identified four components of the government's poverty alleviation package: the Integrated Small Public Works Program (ISPWP); the food stamps scheme; the micro-credit bank and improvements to the *Zakat* and *Ushr* system. Overall, there is a financial commitment of Rs 21 billion for the poverty alleviation package. While the public works program is an old, tried and tested mechanism to address poverty, a number of issues arise in government's announced schemes. First, though the government has announced a budgetary allocation of Rs 21 billion for the ISPWP, it, by and large, appears to be a diversion from other related budgetary heads like rural development, Tameer-e-Watan, physical planning and housing, etc. Also, as much as about Rs 5.8 billion has been cutback from the Social Action Program. As such it is not clear to what extent additional resources are being committed for the purpose of employment generation over and above the level in previous years. Secondly, the institutional framework has not been adequately outlined so the issues of proper targeting which minimises patronage and leakage continue to boggle the mind even though Army monitoring teams should minimises these problems. Finally, the regional profile of poverty highlights the presence of pockets of severe poverty in the country. It appears that poverty is most pervasive in rural Sindh and Balochistan. Even within these regions, it is geographically concentrated. Will the distribution of scarce funds be sensitive to such considerations of relative backwardness? What transparent mechanism will be employed remains unclear.

The food support program which is to target 1.2 million households with an income level of less than Rs 2000 per month, has been earmarked Rs 2.5 billion. The key issue here is the identification of the deserving households. How will a means test be conducted? Like *Bait-ul-Maal*, the institutional framework proposed allows plenty of scope for abuse. Moreover, the support proposed is Rs 29 per head per month. Given that the average poverty gap (extent to which average income of poor is below poverty line) in Pakistan is about 7 per cent, this implies that an average income supplement equivalent to Rs 37 per head per month at least is required to pull these households out of poverty. As such, the amount of support proposed appears somewhat inadequate. Is this also a prelude to the announcement of a big increase in the issue price of wheat?

The third key pillar of the government's poverty alleviation strategy is the micro-credit bank. The existing empirical evidence of the impact of micro credit on poverty is ambiguous. In some countries, it has had a substantial impact while in others the impact has been minimal. The critical thing is the design of the micro finance scheme and its delivery. In the context of Pakistan, experience with micro-financing casts doubts about the success of micro-finance bank in terms of both creating credit disbursement channels and eradicating poverty. It is widely recognised that the micro-financing framework is characterised by targeting inefficiency (poorest are left out), inadequacy of support (insufficient loan size), a low degree of ease of access (problems in joining the community organisations) and lack of self-financing (dependency on donors). So to be a successful initiative the micro-finance bank operation's will have to be designed to overcome these negative features, to the extent possible.

Finally, the government proposes to improve the *Zakat* and *Ushr* system. The critical questions here are twofold: first given the Supreme Court judgement ruling out compulsory *Zakat* deductions for *Sunni* Muslims, how will *Zakat* (that also at a higher rate of Rs 500 per month instead of Rs 300 per month) be financed. With a beneficiary coverage of about 1.1 million, an additional Guzara allowance of Rs 200 per month means an additional *Zakat* outflow of Rs 2.6 billion. In the absence of firm government fiscal commitment how is this to be financed? Second, *Zakat* is flawed with problems of leakages, targeting inefficiency and low coverage

level. It remains to be seen how the task force constituted to review *Zakat* and *Ushr* system addresses these shortcomings.

On the whole, the poverty alleviating interventions proposed by the government are likely to be beset with the problems of targeting inefficiency, fiscal unsustainability, low coverage level, and inadequate support and are, therefore, unlikely to make a big dent on poverty. Given the overwhelming nature of the poverty problem (encompassing about one-thirds of our population) it appears that macro policies which focus on improving the key determinants of poverty like price stability, particularly of basic food items, and higher employment generation through economic revival are more effective mechanisms for reducing poverty in the country. As far as this is concerned, again the impact of government policy is unlikely to be overwhelming. The budget does appear to be anti-inflationary. The effort at fiscal deficit curtailment, and reduction in bank borrowing will curb inflationary pressures. However, at the macro policy level, it does not seem that the budget will "jump start" the revival process of the economy, which has remained slack during the better part of the current decade. There are no bold initiatives which will restore investor confidence, boost the manufacturing sector, enhance exports and thereby escalate the process of growth. Therefore, on the whole it appears that the impact of macro policy on poverty alleviation is unlikely to be sizeable, at least in a short-run framework.

On the whole, the budget presents a framework of poverty reduction which constitutes a move in the right direction. However, the extent to which it can be instrumental in effectively mitigating poverty remains to be seen. Also, it is important to reiterate that diversion of fiscal resources from SAP to the other components of the poverty alleviation strategy is ill advised. SAP focuses on enhancing the income-generating capacity of the poor on a long term basis and, therefore, is the sustainable way to eradicate poverty. It is important that it continues to receive high priority both in terms of higher fiscal allocation and institutional reforms which improve the process of delivery of basic social services in the country. The approach must be to endow and empower people so that they find ways to get themselves out of the vicious cycle of poverty and not make them too dependent on welfare handouts.