Economic instability

ANJUM IBRAHIM ARTICLE (January 07, 2013) : Increasing government expenditure, basic economic theory maintains, is a powerful policy tool useful during times of recession, with low output and low inflation, as it provides the necessary fuel to a stagnating economy and propels the growth rate. In a world where stagflation, defined as high inflation and low output, rears its ugly head a tight monetary policy and a carefully calibrated increase in expenditure is recommended. How much of an increase in government expenditure would lead to the desired result is not an exact science yet, though quantitative economics does claim to come up with some accurate forecasts based on a number of existing factors and some variables. Pakistan has been under the throes of a stagflation for several years which accounts for the International Monetary Fund's (IMF) prescriptions under the 2008 Stand-by Arrangement (SBA): (i) a tight monetary policy with high rates of interest to mop up excess liquidity and reduce the rate of inflation; and (ii) a sustainable budget deficit target that seeks to reduce government reliance on borrowings which would entail: (a) an increase in tax collections, (b) reduction in current expenditure, (c) reforms focused on full cost recovery on all services and infrastructure (social and physical) supplied by the government which would entail targeted subsidies that support only the vulnerable (which implies curtailment of across the board subsidies). In Pakistan, the economic team has been at pains to persistently maintain that the economy's growth has been positive, in marked contrast to the West which remains in the throes of a recession, and that is an indication of the effectiveness of its policies. Or in other words, the contention is that we are not in stagflation where output hovers at 1 percent, if at all, and inflation peaks. A critical element that may explain a positive growth rate in Pakistan is heavy government expenditure (over 3 percent if the Finance Minister is to be believed). However in an economy like Pakistan where physical and social infrastructure remains undeveloped additional outlay on current as opposed to development expenditure has led to an over lubrication of the macro economy. Or in effect inflation continues to rise cumulatively at a fast clip while growth remains linked to external non-policy related factors for example a good monsoon leading to higher farm output, and growth in sectors not backed by higher domestic productivity for example wholesale and retail trade and a rise in services sector that may also be due to a rise in the service charges. In marked contrast development expenditure which fuels output/infrastructure development and generates employment opportunities has the capacity to increase the growth of the economy in an effective and meaningful way. Economists, including the Finance Minister and Deputy Chairman Planning Commission, maintain that private sector is the best engine for growth. In Pakistan, the private sector has lagged behind the public sector for a variety of reasons and to claim that private sector has been an engine of growth is easily refuted given the fact that domestic private sector borrowing is being crowded out by state borrowing, industrial units are shutting down and relocating to other countries and last but not least the electricity and gas loadshedding management plan is compelling those units still operating in the country to shut down till winter is over and the incumbent government considers it politically unsafe to reprioritize industry over domestic users of gas. Pakistani budgets traditionally have had a larger amount allocated for current expenditure relative to development expenditure, (the difference between the two has disturbingly been rising in recent years), and to make matters more of a source of concern the unbudgeted increase in current expenditure is escalating. So where has the government spent the unbudgeted current expenditure rise in the last few years? Not on repaying foreign loans as is being claimed by members of the opposition, both within and outside parliament. The reason is not attributable to lack of trying to get foreign loans but because of the decision by multilaterals and bilaterals not to extend programme lending (budgetary support) due to the sustained failure to implement the agreed reforms in the power and tax sectors. What is inexplicable is the item in the budget documents 2012-13 which notes that the budgeted repayment of loans (not debt servicing) declined from 243 billion rupees to 136 billion rupees last year alone. One can only express amazement at a Finance Ministry whose expectations of foreign debt repayment, not procurement of new loans as that figure was way off from what was budgeted last year, is over a billion dollars higher than what was realized. The unbudgeted rise in current expenditure was also not earmarked for the defence forces fighting the war on terror. The rise in expenditure from what was budgeted last year under defence and related expenses were 35 million rupees, not significant in the budget's overall context. The rise in realized current expenditure in 2011-12 is also not due to a rise in general public service though the rise in executive and legislative organs was a hefty 313.8 billion rupees last year or over 3 billion dollars. So what accounts for this rise? An increase in subsidies to the power sector: from the budgeted 122 billion rupees to the realized 419 billion rupees for Wapda/Pepco and from 24.5 billion rupees to 45 billion rupees for Kesc. The Ministry of Finance could, at best, be held responsible for willfully understating the amount to give a sustainable budget deficit or, at worst, to have such poor forecasting capacity that it was unable to come up with a more credible figure. And the reason for the continued power sector crisis is the sustained failure to agree on a strategy acceptable to all the government stakeholders (relevant ministries) under a Ministry of Finance led committee. So what is our Finance Minister doing wrong? His critics argue that the list would be shorter if one poses the question: what is he doing right? In his defense one would be forced to admit that he did little that was different from what past Finance Ministers did which was to allocate a steadily rising amount on current as opposed to development expenditure and not have enough political clout to challenge the incumbent government on its wasteful expenditure or indeed to compel it to support a tax system that is equitable, fair and non-anomalous. The policies that would take us towards development and out of stagflation are evident and are known to the Finance Minister namely to end exemptions on taxes and render the system equitable and non-anomalous with details of what exactly to do already identified in several reports that are gathering dust in government cupboards; slash expenditure and mainly current expenditure, and last but not least implement power sector reforms so that it does not remain the single major impediment to industrial output. While the current economic situation would still necessitate an IMF loan given the massive strain on our balance of payment position yet if these policies are undertaken today the desired loan amount would be less as would the amortization period.