A Charter for Change

BALANCING BUDGETS WITHOUT UNBALANCING HUMAN LIVES

(Mahbub ul Haq)

How to balance the budget without unbalancing the lives of the people? That is the real dilemma facing Pakistan's policy makers today.

Obviously, the 1996-97 budget provides the wrong answer to this eternal dilemma. It seeks to balance the budget on the backs of the poor, not on the backs of the rich. It imposes a disproportionate burden on the urban middle class, totally sparing the influential landlords. It piles up more taxes on top of a pyramid of high tax rates rather than making a serious effort to collect existing taxes. It is likely to lead to more inflation, lower production incentives, no major spurt in growth or employment, no visible signals of austerity in government spending. It is a budget without a vision, without a clear sense of direction, without any tangible hope for an increasingly desperate society.

Was there a viable alternative? Can we still choose such a path when the nation faces the unfortunate prospect of paralyzing strikes and disruptive political agitation?

There is no question that our budgets must be balanced. We cannot continue to borrow indefinitely. Balancing the books of the nation is an imperative for national solvency, irrespective of any pressures from the IMF. But when a national crisis looms, everyone must sacrifice -- particularly the rich, not just the poor.

There are several steps that can be taken even now to balance the budget without destroying the lives and livelihoods of poor people. Let me suggest a few, which require a total revamping of the present budget strategy.

First, the proposed increase in general sales tax and its extension to many additional items should be withdrawn in this climate of rising prices and worsening poverty. It should be replaced by extending the Federal income tax system to all forms of income --- whether agricultural or non-agricultural, irrespective of its source. This will tax the rich landlords and could possibly yield over Rs.30 billion, if properly enforced. Of course, the influential landlords sitting in our legislatures will vigorously resist such a proposal. But they must be reminded to carefully weigh the costs of a timely reform against the risks of a violent urban revolt.

Second, the present income tax system must be made fair and enforceable. There is a good deal of competitive tax evasion today, born out of a perception that everyone else is cheating as well. There is, at the same time, a complete disrespect for our tax laws since no one is being sent to prison for tax evasion. I am personally in favour of lowering the marginal income tax rate from 38.5% to 25% and then strictly enforcing its collection, both through a progressive documentation of the economy and by sending tax evaders to jail upto five years under the existing law. I am convinced that present income and wealth tax collections can be improved by at least 25% (Rs.22 billion) if tax discipline is enforced at all levels and if the ruling class sets an example by paying its own taxes scrupulously and in a transparent and open manner.

Third, our annual debt servicing burden of Rs.186 billion (roughly 9% of GNP) has now reached such a staggering level that, unless something fundamental is done about it, it is likely to start consuming most of our tax revenues. Pretty soon, we shall be taxing our people mainly to pay interest on our past debts -- with no resources left for anything else, whether for administration, or defence, or development. The most expensive part of this debt is domestic, which is now close to Rs.860 billion (nearly 40% of GNP) and consumed Rs.126 billion (about 6% of GNP) of budgetary resources in the 1995-96 budget. We should draw up a concrete plan to swap this domestic debt against privatisation of our public assets over the next four years. During the next fiscal year (1996-97), let us make a determined effort to sell at least Rs.200 billion of our assets -- particularly, PTC, power stations, gas companies, banks and DFIs --- in domestic and international markets, by floating public shares and letting the free market competition determine a fair price rather than government negotiations. If every penny raised in this manner is used for domestic debt retirement, it will not only give us considerable cushion of foreign exchange, it will also reduce our interest payments next year by roughly Rs.30 billion. In the next four years, we can wipe off most of our domestic debt, which will help considerably in balancing the budget as well as in finding significant resources for financing urgently-needed basic social services of education, health, nutrition and safe drinking water.

Fourth, it is estimated that over Rs.110 billion are locked up at present in "stuck-up loans" in nationalized banks. These loans are mostly in the hands of influential people who possess considerable assets and who are in a position to pay if government shows the necessary political will. Why not levy a penal rate of 20% a year on these stuck-up loans and collect a substantial sum for the budget even if it requires auctioning the assets of the delinquent borrowers?

Fifth, there is a provision of Rs.105 billion for the public sector development programme. Can anyone seriously doubt that the same size of development effort could be delivered at 20% less cost (a very conservative estimate) if various kick-backs and corruption are eliminated from this programme? That will be a saving of at least Rs.20 billion. In fact, what is needed is not a reduction in the size of development expenditure but more efficient and cost-effective spending of these resources to get more mileage out of development funds and to provide greater opportunities for economic growth and employment.

Sixth, what about some relief for the masses? All over the world, budgets are used as an instrument to tax the rich and transfer income to the poor. Pakistan transfers less than 0.5% of its GNP to the poor through Zakat, Baitul Mal and other budgetary subsidies -- about the lowest ratio in any country -- compared to around 15% in USA and UK and 35% in Sweden. Why not, for instance, tax some forms of luxury consumption at a very high rate to finance a 50% subsidy on atta for the poor? Why not restore indexation of the salaries of fixed income groups and pensioners? The precise mechanisms can be discussed. The point of principle is whether we shall keep using the budget to transfer income from the poor to the rich -- as we have continued to do in our feudal culture till we are now risking an open revolt -- or shall we follow the tradition of civilized societies and start transferring income from the rich to the poor?

There are several other issues that can be mentioned in the context of the budget though their immediate revenue impact will not be large.

It is true that defence expenditure takes away a major part of our budget but it is also true that there can be no compromise on our national security needs and that our defence expenditure has not increased in the last two years, after adjusting for inflation. Our only option in the short run is to design a new budgetary paradigm where the legitimate claims of both defence and development can be met through more efficient management of our national resources. In the long run, of course, both Pakistan and India can gain a great deal by resolving their outstanding disputes and by creating a new environment of detente which enables both these countries to invest more in their people than in arms. Such a process of normalisation must be initiated now, before we enter a new and more expensive missile race. However, any such process is likely to take some time to succeed and the first positive steps in this process may have to be taken by the bigger neighbour.

We also need some visible gestures for adopting a culture of austerity in government spending -- for example, slashing budgetary allocations for the maintenance of Prime Minister's and President's houses (rather than rubbing salt in the wounds of the nation by increasing these allocations); eliminating the perks of duty - free Mercedes and other facilities for high officials; drastically curtailing foreign delegations, needless seminars and conferences, and free medical treatment abroad; cancelling the allotment of plots to members of parliament at throw-away prices. To be realistic, budgetary savings are quite small in these measures. But these steps are politically important if the entire nation is asked to tighten its belts.

Our people have patiently borne many burdens, made many sacrifices. Today, they are nearing an open revolt because the current budget reconfirms their perception of a corrupt ruling class exploiting the poor and the weak. Calls for national sacrifice sound hollow when national deficits are deficits of dishonesty. These deficits arise because the rich are simply refusing to pay their due share of taxes and because there is considerable leakage of revenue in corruption. People can be persuaded to sacrifice if they sense that there is a real national crisis where all segments of society are making their contribution according to their capacity. But even the normally hapless people revolt when they realize that they are being made to bleed white for the benefit of the rich, the corrupt, and the powerful.

Our budgetary failures are not technocratic failures but political failures. Successive governments have always received a surplus of sound technocratic advice but often chosen to ignore it. The same is likely to happen now. Many of the steps suggested above stand little chance of acceptance in the current political climate. In that case, our present budgetary crisis will continue. In due course of time, the economic laws and the demands for justice and fair play will wreak their own vengance on the system -- with consequences as dire and as inevitable as they have always been through recorded history.

Dr. Mahbub ul Haq is President of the Human Development Centre and a former Finance Minister. He was away from the country when 1996-97 budget was presented in June. He contributed this comment on his return this week.