BACKGROUND PAPER

Strengthening National and Provincial Legislative Governance

BUDGETING FOR POVERTY REDUCTION

PILDAT
Pakistan Institute of Legislative Development And Transparency

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Prepared By

Pakistan Institute of Legislative Development And Transparency - PILDAT

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ABBREVIATIONS AND ACRONYMS

FY	Fiscal Year
GDP	Gross Domestic Product
GNP	Gross National Product
GOP	Government of Pakistan
HIES	Household Integrated Economic Survey
NGO	Non-Governmental Organization
PILDAT	Pakistan Institute of Legislative Development And Transparency
PLSC	Pakistan Legislative Strengthening Consortium
SBP	State Bank of Pakistan
SPDC	Social Policy and Development Centre
US	United States

FOREWORD

"***Budgeting for Poverty Reduction***" is designed to serve as a support document which helps enhance the parliamentarians' knowledge about the complex nature of poverty and provides practical options for developing pro-poor budgetary policies. The paper, written by Dr. Kaiser Bengali, one of Pakistan's leading economists and Managing Director of the Social Policy Development Centre (SPDC), presents his analysis of poverty in Pakistan and the role of budgetary allocations in development and poverty alleviation. We hope that this will inspire more debate and we welcome different perspectives on the subject.

The Budget is an important policy document through which the government establishes its economic and social priorities and sets the direction of the economy. It reflects the fundamental values underlying the government's economic policies and objectives. As elected representatives, parliamentarians can play a crucial role in defining these objectives and priorities. The parliament is the most appropriate place to ensure that the Budget best matches the nation's needs. It is therefore imperative for the parliament to play a proactive role in the budget process and in determining budgetary allocations. However, in order to play this role effectively, parliamentarians require research infrastructure and support. PILDAT aims to provide comprehensive, concise and up-to-date information to parliamentarians on important policy issues with the view to expand their knowledge base and equip them with the tools to effectively engage in legislation, policymaking and oversight.

PILDAT would like to thank Dr. Kaiser Bengali, Managing Director, SPDC, and his team of researchers for writing the paper.

PILDAT and its team of researchers have made every effort to ensure the accuracy of the contents of this paper. We, however, do not accept responsibility of any omission or error, as it is not deliberate.

The views expressed in this paper belong to the author and are not necessarily shared by PILDAT, PLSC or USAID.

Lahore
June 2004

PROFILE OF THE AUTHOR

Dr. Kaiser Bengali is the Managing Director of the Social Policy and Development Centre in Karachi. He has a Masters degree in Economics from Boston University, USA and a PhD in Economics from University of Karachi, Pakistan. He served as a Research Economist/Assistant Professor at the Applied Economics Research Centre, University of Karachi, from 1979 -1995, where he taught Microeconomics, Urban Economics and Public Enterprises. He also taught a Seminar Course in Development, Industrialisation and Employment at the Pakistan Institute of Lahour, Education and Research, and Economics of Planning at the Department of Economics at the University of Karachi.

During his teaching career, Dr. Bengali lectured at the Institute Universitaire Du Etudes Du Developement at the University of Geneva, Switzerland and has also served as Visiting Fellow at the Institute of Development Studies, University of Sussex, UK.

Dr. Bengali has written over 30 research articles published in various national and international journals and conferences and completed over 20 consultancy assignments with several organizations including the World Bank, International Labour Organization and United Nations World Food Programme.

Dr. Bengali is also the author of two books titled, “Why Unemployment?” and “The Politics of Managing Water”.

1. INTRODUCTION

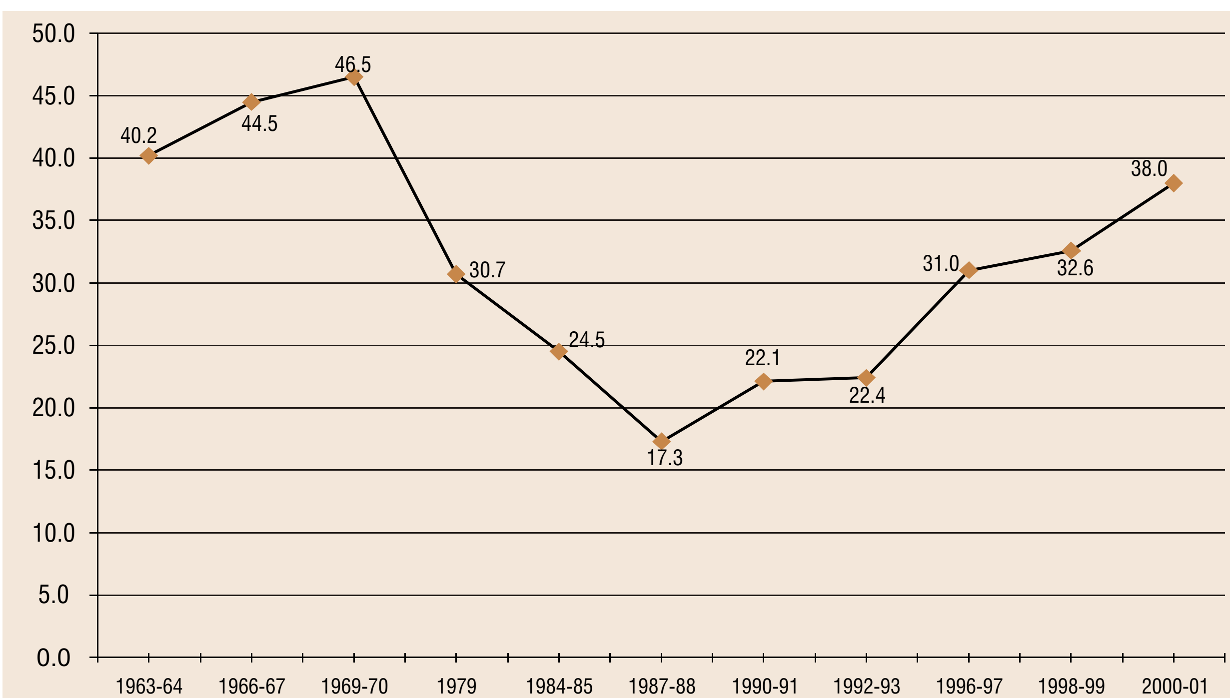
There are various estimates of poverty in Pakistan, ranging from 32 to 40 percent. This means that more than 50 million people are living in a state of poverty. This has increased from 17 percent in 1988, down from a peak of 47 percent in 1970 [see chart 1]. The fall and rise of poverty is a function of the political economy associated with specific periods in the country's history.

2. HISTORICAL OVERVIEW

The 1960's is said to be the golden period of economic development in Pakistan. Substantial progress in agriculture, industry, power generation and communications occurred during the decade. A singular achievement during this period was the unprecedented scale of asset creation in terms of economic infrastructure and productive capacity. Unfortunately, investment gains were not accompanied by distribution gains, since the development process led to increased inequalities between income groups and between regions. While the decade produced the proverbial 22 families, which controlled three-fourths of non-agricultural wealth, the purchasing power of industrial labour declined by one-third. Not surprisingly, the percentage of people below the poverty line rose from 40 percent in 1964 to 44 percent in 1968. The class impact of unequal growth led to political upheavals, while the regional impact led to civil war and secession of East Pakistan.

The period 1972-77 is viewed from two perspectives. There is a body of opinion at the lower strata of income, which considers the 1970's as the actual golden period of development in the country. By contrast, opinion at the upper end of the income strata differs sharply. It is felt that the thrust of policies, particularly the nationalization of industry and finance, led to the “ruin” of the economy. Opinions are a product of interests and it is understandable that the interests and opinions of people at opposite ends of the income spectrum are different. An objective opinion needs to be formulated based on the analysis of official economic data.

CHART 1: NUMBER OF POOR AS % OF POPULATION



Source: Pakistan Economic Survey (various issues)

The period commenced in the shadow of massive economic dislocation caused by a disastrous war and breakup of the country. The subsequent nationalization of industry and finance too dented private sector confidence rather severely. However, economic growth was unaffected, as the focus of growth shifted to the public sector, where it accelerated. GDP growth rates were relatively lower, but investment rates were high, particularly in economic infrastructure and large-scale capital goods industry. Work commenced on such high value projects as the Port Qasim, Indus Highway, Steel Mill, heavy electrical and mechanical complexes, etc. Macroeconomic data points to the sound health of the economy during 1972-77. There was a healthy current account surplus (current account is a record of all international transactions for goods and services; it combines the transactions of the trade account and the services account), which ensured a robust level of growth at 21 percent per annum in development expenditure and at 18 percent in gross fixed capital formation. Economic policies also had a large element of egalitarianism. The period saw the largest increase in housing provision to date, with the share of pucca housing in total housing stock more than doubling from 9 percent in 1973 to 20 percent in 1977. The public investments in development projects and the resultant secondary economic activities created significant employment opportunities, with the result that the percentage of population below the poverty line declined from 47 percent in 1970 to 31 percent in 1979.

The period 1977-1988 saw an improvement in GDP growth rates and continued decline in poverty on account of the following. One, the large infrastructure and industrial projects initiated during the previous era came on-stream in the 1980's and delivered large income flows for the national economy. Two, remittances from the Middle East began to peak from the early 1980's onwards. Three, large windfall gains began to be accrued on account of the war in Afghanistan. And four, large debts were incurred to finance the high levels of current expenditure, thereby, doubling the domestic debt-GDP ratio from 24 percent in 1977 to 48 percent in 1988. The inflated debt burden had to be serviced during the post-1988 period.

The 1977-1988 decade also saw a decline in public investment rates to about one-tenth of the average of the 1972-77 period. Not only was new capital not created, replacement investment in existing capital also did not occur. The debt-servicing burden, aggravated by the financial liberalization in 1992, ensured that development

TABLE 1: PERFORMANCE OF SELECTED STABILIZATION INDICATORS

Year	Overall Budget Deficit (As % of GDP)	Current A/C Balance (As % of GDP)	Inflation Rate (%)	Forex Reserves (in US million $)
1988	-8.5	-4.4	9.6	468
1989	-7.4	-4.8	8.6	496
1990	-6.5	-4.7	6.5	764
1991	-8.7	-4.8	13.1	672
1992	-7.4	-2.8	9.9	1,066
1993	-8.1	-7.2	8.9	599
1994	-5.9	-3.8	12.6	2,543
1995	-5.6	-4.1	13.6	2,933
1996	-6.5	-7.2	8.3	2,463
1997	-6.4	-6.2	14.6	1,286
1998	-7.7	-3.1	6.5	1,125
1999	-6.1	-4.1	5.9	2,379
2000	-6.6	-1.9	2.8	2,163
2001	-5.2	-0.9	6.0	3,244
2002	-5.2	2.3	3.2	6,398
2003	-4.5	4.4	4.5	10,747

Sources: Pakistan Economic Survey (various issues); SBP Annual Report (various issues)

TABLE 2: PERFORMANCE OF SELECTED GROWTH INDICATORS

	1977-78 to 1987-88	1988-89 to 1998-99	1999-00 to 2002-03	1999-00	2000-01	2001-02	2002-03 Provisional
GDP Growth Rate	6.9	4.1	4.1	4.4	3.3	3.4	5.1
Agriculture	4.0	4.5	1.9	6.1	-2.5	-0.1	4.1
Manufacturing	9.2	4.2	5.4	1.8	7.0	5.0	7.7
Tertiary Sectors	7.3	4.6	3.6	3.5	3.5	2.7	4.8
Domestic Savings (% of GDP)	9.2	15.7	15.7	14.9	14.9	16.8	16.2
Fixed Investment (% of GDP)	18.3	16.3	13.3	13.7	13.3	13.1	13.1
Public Investment (% of GDP)	10.3	8.3	5.3	5.9	6.0	4.8	4.5
Private Investment (% of GDP)	8.0	8.3	8.1	7.9	7.3	8.4	8.6
Growth in Foreign Direct Investment (US $ Million)	-	16.0	-8.1	25.0	-31.4	50.3	-76.4
Saving-Investment Gap to GDP Ratio	-	-4.9	-0.2	-1.9	-2.0	2.1	0.8
Growth Rate of Export of Goods	10.7	4.7	12.1	14.1	15.2	2.3	16.6
Growth Rate of Import of Goods	5.3	3.9	3.8	-1.2	2.0	-7.5	21.9

Sources: Pakistan Economic Survey (various issues); SBP Annual Report (various issues)

expenditure continued to be cut in the 1990's as well. This led to a sharp decline in the productive capacity of the economy in agriculture as well as in manufacturing -- and has manifested itself increasingly since the 1990's.

The change of regime in 1999 led to the rigorous enforcement of the macroeconomic stabilization agenda. Policymakers have claimed that achieving macroeconomic stability is the essential pre-requisite for sustained growth. Critics have disagreed. However, the disagreement is not over the necessity of stability, but over the sequencing of stabilization and growth paths, the cost at which stabilization objectives have been achieved, and the distribution of the costs of reform and adjustment. As it appears, stabilization was achieved at the cost of growth and a disproportionately large part of the cost was placed on the poor [see Tables 1 and 2]. Consequently, partly as a result of stabilization policies and partly as a result of mismanagement of the impact of drought, a record 7 million people fell below the poverty line between 1999 and 2001.

3. INFLATION AND THE POOR

Changes in the inflation rate offers one clear indication of the opposing impacts of stabilization measures on macroeconomic statistics and on the poor. The reduction and containment of the inflation rate from a peak of nearly 15 percent in 1997 to below 5 percent post-1999 is billed as one of the key successes of macroeconomic stabilization measures. Generally, a lower rate of price increases should be beneficial for the poor, as it protects their real incomes. The fact that this has not been the case merits a somewhat detailed explanation.

Prices are determined by the combination of supply and demand factors. On the supply side, an escalation of production costs is likely to lower output and exert an upward pressure on prices. On the demand side, a contractionary monetary and fiscal policy[1] is likely to curtail purchasing power, weaken market demand and exert a downward pressure on prices.

The situation in Pakistan has been as follows. Enhancements in domestic taxes and utility and gasoline prices have raised production costs. This is clearly evident from the fact that while average wholesale prices have increased over 1988-2003 by 8.2 percent, sales taxes have increased by 10 percent, gas prices by 9 percent, electricity charges by 15 percent and high speed diesel prices by 13 percent [see table 3]. These cost-push factors have tended to impact the commodity producing sectors in

1. Contractionary monetary policy contracts (decreases) the supply of a country's currency. Contractionary fiscal policy is a government policy of reducing spending or raising taxes, or a combination of both.

TABLE 3: TRENDS IN MANUFACTURING PRODUCTION COST COMPONENTS

Years	Maximum import duty rate (%)	Effective import duty rate (%)	Share of import duty in total taxes (%)	Share of sales tax in total taxes (%)	Electricity (Fixed/ minimum Rs. Per kwh)	Electricity (Energy charges Rs. Per kwh)	Gas (Rs. Per 000 cu. ft.)	High Speed diesel (Rs. Per litre)	Wholesale General Price Index (1990-91=100)
1987-88	150	38.4	43.0	9.2	66.0	0.62	47.4	3.8	76.1
1988-89	125	34.5	40.6	13.2	73.5	0.69	47.4	3.8	83.4
1989-90	125	36.2	41.9	16.5	90.0	0.84	47.4	3.8	89.5
1990-91	125	34.1	40.4	14.9	97.5	0.92	54.5	5.6	100.0
1991-92	95	30.3	39.2	13.5	97.5	0.92	54.5	5.0	109.8
1992-93	90	27.7	37.6	13.7	97.5	0.92	54.5	5.8	117.9
1993-94	80	28.9	32.7	15.4	97.5	1.92	67.7	6.1	137.3
1994-95	70	26.9	32.9	17.4	124.5	2.92	84.0	6.4	159.2
1995-96	65	24.9	30.3	17.4	124.5	2.92	89.0	7.9	176.9
1996-97	65	23.6	26.7	18.0	124.5	3.50	102.4	9.9	199.9
1997-98	45	22.0	22.8	15.7	124.5	4.04	102.4	9.6	213.1
1998-99	45	18.4	16.1	19.1	224.5	3.47	102.4	11.0	226.6
1999-00	35	17.8	16.7	30.9	224.5	3.47	138.0	15.4	230.6
2000-01	30	16.8	14.1	35.4	224.5	3.68	157.8	17.0	244.9
2001-02	25	11.8	10.0	34.8	290.0	3.5	166.1	21.4	250.1
2002-03	25	15.8	12.5	35.5	290.0	3.8	172.2	22.5	264.9
Average Growth Rate	-10.0	-4.6	-6.6	10.3	11.2	14.6	8.9	12.7	8.2

Sources: Economic Survey (various issues); Energy Year Book (various issues)

general, and the manufacturing sector in particular, rather adversely. Growth in output dropped exerting an upward pressure on prices.

At the same time, the contractionary monetary and fiscal policies, represented by sharply lower growth in money supply and sharp cuts in public investment, have tended to impact purchasing power negatively. The fall in purchasing power has led to lower price increases. In fact, growth in prices is entirely on account of cost-push factors. The combination of the cost and demand factors has led to a deceleration in output as well as prices. The fall in output growth is greater, resulting in a rise in unemployment.

While inflation is not the cause of poverty growth in an aggregate sense, price increases have been above average in several key items, particularly food, impacting severely on the poor. The principal element in poverty growth, however, appears to be unemployment related factors. Landlessness has grown in rural areas. The collapse of investment has closed avenues for employment generation. Many of those who have been rendered unemployed have moved to lower wage opportunities in the informal services sector. The enhanced rate of entry into the informal service sector has augmented labour supply, and with product demand remaining the same, average earnings have declined. Unemployment tends to take away income altogether and low inflation is of little benefit to households that no longer command the same income and, cannot, therefore, be expected to be pleased with the fact that the average price line is stable. Ironically, far from low inflation benefiting the poor, it is growth in poverty itself that has been responsible for low inflation.

4. A MEASURE OF POVERTY

One way to view poverty is through the composition of the budgets of households, since the share of food cost in total household expenditure is considered as an indicator of welfare. A higher share of food cost in the household budget is said to be indicative of a relatively higher level of poverty and a lower share of food cost implies a relatively higher level of prosperity.

This phenomenon occurs because food, clothing, shelter services and health care are essential expenditure heads and take precedence over other needs. Of these, food is the most important. In economic terminology, the elasticity of demand for these goods and services is low on account of the fact that households cannot substitute these goods and services for less expensive substitutes. Households with small incomes have little left for non-essential expenditures after meeting food and other essential needs. Thus, the share of food and other essential costs in lower income household budgets tends to be higher. The opposite is true for households with larger incomes, which are left with a surplus after meeting their basic needs. Hence, the share of food and other essential expenses in higher income household budgets tends to be lower.

The low substitutability factor also implies that as food prices rise and nominal income remains constant, a greater share of income has to be devoted to food by reducing allocations to other relatively less essential items.

TABLE 4: EXPENDITURE SHARES - LOWEST QUINTILE OF POPULATION (%)

Major Commodity Groups	1988			1988			2002		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
Food	40.8	45.9	44.6	40.5	47.8	46.5	55.5	56.1	55.9
Clothing	8.4	9.3	9.1	7.4	9.0	8.5	7.9	11.0	10.1
Fuel and Lighting	7.0	6.8	6.8	8.0	7.3	7.5	10.6	6.0	7.3
Housing	12.9	7.6	9.2	14.5	7.8	9.7	8.0	7.4	7.6
Transport	2.1	2.2	2.2	1.3	1.2	1.3	2.7	2.8	2.7
Health	2.4	2.8	2.7	3.9	4.6	4.4	3.9	6.0	5.4
Education	0.6	0.9	0.7	3.5	1.4	2.0	4.2	2.0	2.7
Items for Household and Personal Care	9.1	9.0	8.9	7.2	7.1	7.1	3.7	4.2	4.0
Consumer durables	1.6	2.4	2.2	1.1	0.8	0.9	0.8	0.9	0.9

Source: HIES (1987-88) and (1998-99)

TABLE 5: EXPENDITURE SHARES - HIGHEST QUINTILE OF POPULATION (%)

Major Commodity Groups	1988			1988			2002		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
Food	26.4	34.4	30.6	26.0	36.8	31.5	39.6	46.1	44.2
Clothing	9.1	10.1	6.0	14.4	14.1	7.1	6.2	8.9	8.1
Fuel and Lighting	5.8	4.6	5.4	5.8	7.7	6.7	8.7	7.6	7.9
Housing	21.5	9.9	13.6	21.3	9.5	13.5	15.0	7.5	9.7
Transport	5.6	4.0	4.5	4.8	3.1	3.8	6.3	5.7	5.9
Health	2.4	2.7	2.5	3.5	4.9	4.2	4.6	7.0	6.3
Education	1.8	0.6	1.2	5.0	1.9	2.8	6.2	3.2	4.1
Items for Household and Personal Care	5.5	5.3	5.2	8.8	6.7	7.9	3.8	3.7	3.7
Consumer durables	3.3	4.7	4.2	2.1	2.2	2.2	2.7	3.0	2.9

Source: HIES (1987-88) and (1998-99)

The greater share of income need not necessarily imply an increase in food intake; in fact, it could be accompanied by a reduction in food intake. Accordingly, an increase in the share of food in total expenditures is an indication of further impoverishment.

A perusal of data confirms this fact. Households in the lowest quintile[2] devote over 56 per cent of their budget to food, compared to households in the highest quintile who devote just over 44 per cent [see Table 4 and 5]. The change in the household budget composition over the last decade and a half for the lowest and highest quintiles is also meaningful. The share of food costs has increased for both quintiles, but the increase is greater for the lowest quintile than for the highest quintile. This indicates an intensification of poverty at lower levels. The current spur in the prices of wheat and other food items has further accentuated poverty. Table 6 shows that households in Pakistan have responded to inflation (i.e., reduction in real income) through keeping their expenditure on wheat more or less constant, but reducing expenditure on other food items. The implication is that poverty precludes households from consuming a balanced diet; thereby, exposing themselves to problems arising out of nutritional deficiencies.

TABLE 6: SHARES IN HOUSEHOLD BUDGETS BY INCOME GROUP

	Wheat	Rice	Dairy	Meat	Sugar
Income Group - 1					
Bottom 20%					
1987-88	12.6	1.8	9.4	3.8	3.9
1998-99	13.5	1.6	4.1	1.8	2.2
% ⇄	0.67	-0.81	-7.29	-6.73	-4.96
Income Group - 2					
1987-88	9.5	1.9	9.4	4.3	3.6
1998-99	12.1	1.8	3.7	2.2	1.9
% ⇄	2.22	-0.23	-8.07	-5.76	-5.39
Income Group - 3					
1987-88	7.8	1.8	9.3	4.2	3.3
1998-99	10.4	1.8	4.1	2.5	1.7
% ⇄	2.64	0.09	-7.24	-4.75	-5.81
Income Group - 4					
1987-88	5.9	1.7	9.2	4.4	2.8
1998-99	7.8	1.7	4.5	2.9	1.5
% ⇄	2.54	0.33	-6.26	-3.69	-5.56
Income Group - 5					
Top 20%					
1987-88	3.0	1.2	6.6	3.9	1.7
1998-99	3.9	1.2	4.1	3.1	0.9
% ⇄	2.45	0.00	-4.32	-1.97	-5.64

Source: HIES (2002)

2. Refers to the lowest 20 per cent income bracket

A comparison of the incidence of poverty across provinces shows that a north-south divide has emerged. Punjab reports the least incidence of poverty and Balochistan the highest. The incidence of poverty in Punjab and NWFP is below 30 percent and rural poverty is less than urban poverty. In Sindh, 31 percent of the population and 38 percent of the rural population are reported to be below the poverty line. In Balochistan, about half the population is below the poverty line. [see Table 7].

TABLE 7: POVERTY INCIDENCE
[Percentage of Population Below the Poverty Line]

Province	Overall	Rural Areas
Punjab	26	24
Sindh	31	38
NWFP	29	27
Balochistan	48	51

Source: Pakistan Integrated Household Survey, 2000-01 and estimated welfare functions.

5. INEQUALITY FACTOR IN POVERTY GROWTH

The increase in poverty can occur on account of the decline in income. However, while the rate of GDP growth in Pakistan has been reduced post-1996, it has continued to be positive. In other words, GDP has not declined. Given that GDP has remained positive, poverty can not be expected to rise. However, this is precisely what has happened. The explanation lies in the growing inequality of the distribution of income; i.e., the bulk of increases in national income is appropriated by the upper income groups.

This is evident from the fact that households in the lowest quintile command an income share that is significantly less than their population share, while households in the highest quintile command income share that is significantly more than their population share. Over the period 1988-2002, the share of the lowest quintile has consistently declined and that of the highest quintile further increased. This phenomenon can be observed in urban as well rural areas.

The most glaring information is provided by the share of income accruing to the lowest 20 per cent (i.e., the lowest quintile) and to the highest 20 per cent (i.e., the highest quintile) of the population. Statistics show that the poorest 20 percent of the population earn 7 percent of income (down from 9 percent in 1988) and the richest 20 percent of the population earn 48 percent of income (up from 44 percent in 1988) [see Table 8]. In absolute terms, if Rs. 100 is to be distributed among 100 households, equal distribution would imply that each household receives Rs. 1.00. Given the actual situation of unequal distribution, the top 20 households would each receive Rs. 2.33 and the bottom 20 households would receive a mere 40 paisa each. Income distribution has also worsened over time. Between 1988 and 2002, the real incomes (purchasing power) of the richest 10 percent of the population has increased substantially by 33 percent, while that of the poorest 10 percent has actually declined by 9 percent. In other words, if in 1988, Family A in the richest income group and Family B in the poorest income group each earned Rs. 100, in 2002 Family A earned Rs. 133 and Family B earned Rs. 91.

6. ROLE OF THE BUDGET

The Budget is an important policy document that sets forth the priorities of the government and the directions that the economy is desired to be taken towards. It has far reaching impact on all sectors of the economy and on all sections of the population. It allocates and reallocates resources from one sector to another and from one set of pockets to another. It determines the efficiency of resource use and has profound distributional impacts.

Of late, policymakers have addressed the budgeting exercise from the almost exclusive perspective of reducing

TABLE 8: INEQUALITY MEASURES

	1988	1999	2002
Gini Coefficients[3]			
Pakistan	0.35	0.40	0.41
Urban	0.40	0.42	0.44
Rural	0.30	0.36	0.35
Income Share of Lowest 20% Population			
Pakistan	8.8	7.8	7.0
Urban	7.8	6.6	6.6
Rural	9.6	8.7	8.0
Income of Highest 20% Population			
Pakistan	43.5	46.5	47.6
Urban	47.8	50.1	50.3
Rural	40.0	41.8	43.2
Ratio Highest to Lowest			
Pakistan	4.9	6.0	6.8
Urban	6.1	7.6	7.6
Rural	4.2	4.8	5.5

Source: Household Integrated Economic Survey (HIES) (1987-88), (1998-99) and (2001-02)

the budget deficit, the current account deficit, the savings deficit and the rate of inflation. These are laudable macroeconomic stabilization objectives. However, the way in which these targets are achieved has different distributional implications. There exists a range of policy options to achieve given ends, some of which are pro-poor and others that are not [see Box 1].

An analysis of the manner in which budgetary policies have been framed and executed betrays an absence of pro-poor orientation. This is evident from the fact that budget deficit reduction has been achieved through enhancement of indirect taxes and reduction of development expenditure, including social sector expenditure.

Over 1988-2003, GDP has grown at 4.5 percent, while indirect tax revenues have grown at 12 percent. Within indirect taxes, sales tax revenues have grown at 25 percent and import duty revenues at 6 percent [see chart 2]. Consequently, the share of sales taxes in total tax revenue has increased from less than 10 percent in 1988 to over 35 percent in 2003, while the share of import duties has declined from over 40 percent to about 15 percent [see chart 3]. This shift has impacted adversely upon the ability of the country's manufacturing sector to compete with imports.

On the expenditure side, current expenditure growth over 1988-2003 has outstripped growth in development expenditure by a factor of nearly 2:1. Current expenditure has grown at 12.2 percent as against the growth of 6.7 percent in development expenditure. Annual real social sector expenditure growth has also declined, with the post-1997 period registering actual declines in social sector real expenditure [see table 9].

The trends in current and development expenditure are disturbing. Earlier, development expenditure and social sector expenditure reduction was explained on grounds of resource constraints. However, FY2003 witnessed a decline in development expenditure despite availability of resources. The year reported a 4 percent or Rs. 26.7 billion

3. The Gini Coefficient is a number between zero and one that measures the degree of inequality in the distribution of income in a given society, where 0 is perfect equality and 1 is perfect inequality

surplus in Gross Revenue Receipts over the budgeted target and an 11.1 percent or Rs. 32.3 billion saving in Debt Servicing expenditure. The total available 'fiscal space', thus, amounted to about Rs. 59 billion. Yet, actual current expenditure was increased by Rs 65 billion and actual development expenditure was reduced by Rs. 14 billion over budgeted expenditures.

BOX 1: POLICY OPTIONS: HELPING OR HURTING THE POOR?

Raising revenues or reducing expenditures can lower the budget deficit. Revenues can be raised through direct taxation or through indirect taxation: the former impacts the rich, while the latter largely impacts the poor. Expenditure reduction can be attained through cuts in current expenditure or through cuts in development expenditure. The former impacts on existing employment, while the latter impacts on employment generation. However, while development expenditure is likely to create assets and a future stream of income, current expenditure is likely to be consumptive. Generally, labour productivity in employment, generated through development expenditure, is likely to be higher in employment generated through current expenditure. Thus, while employment on account of development expenditure may be productive, employment on account of current expenditure may be non-productive. As such, switching expenditure from current to development heads may increase employment and incomes, and reduce poverty in the future.

The current account deficit can be lowered through changes in both the trade and non-trade related categories. With respect to trade categories, the current account deficit may be reduced on account of higher export receipts or lower import payments. The changes may be the result of an increase in the value or volume of exports or a decrease in the value or volume of imports.

Higher export receipts on account of higher value of exports are likely to accrue more foreign exchange for the same level of output, as well as enhancing incomes for exporters and generating growth. Higher export volume is likely to generate more output and employment, leading to higher income. Lower import volumes, at Pakistan's current level of development, are likely to be reflective of recessionary tendencies, i.e., a slow- down in economic activity, and impact adversely on employment, income and growth.

With respect to non-trade categories, the current account deficit may be reduced through lower debt servicing on account of debt retirement or write-offs or rescheduling. Lower debt servicing on account of debt retirement or write-offs releases resources for investment or consumption without future liabilities, while debt rescheduling transfers liabilities to future generations. This liability can be neutralized if the resources released are employed for the creation of income generating assets.

The savings deficit can be lowered through an increase in savings or decrease in investment. The increase in savings can be employed to finance investment, which is likely to generate employment and income. To the extent that the increased output is exported, there is a positive impact on the current account. A decrease in investment reduces output, employment and income. The contraction in output may also impact adversely on exports and on overall growth.

Inflation can be lowered through controlling cost-push or demand-pull factors. The former involves intervening on the supply side and reducing the cost of production, which tends to enhance product competitiveness. The latter involves intervening on the demand side by curtailing both purchasing power and consumption. Where consumption levels are already below subsistence standards, further reductions can have adverse effects on nutrition and health, as well as on social stability.

CHART 2: AVERAGE GROWTH RATES (1988-2003)

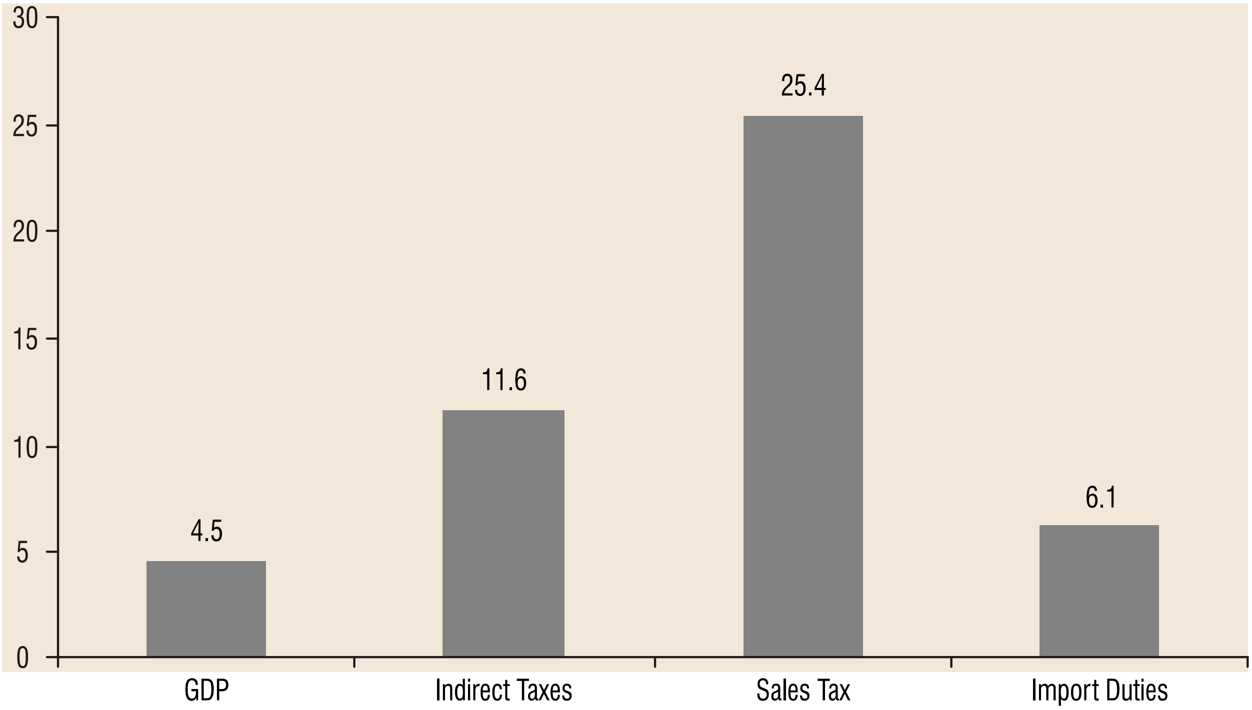


CHART 3: TREND IN SALES TAX AND IMPORT DUTY RECEIPTS

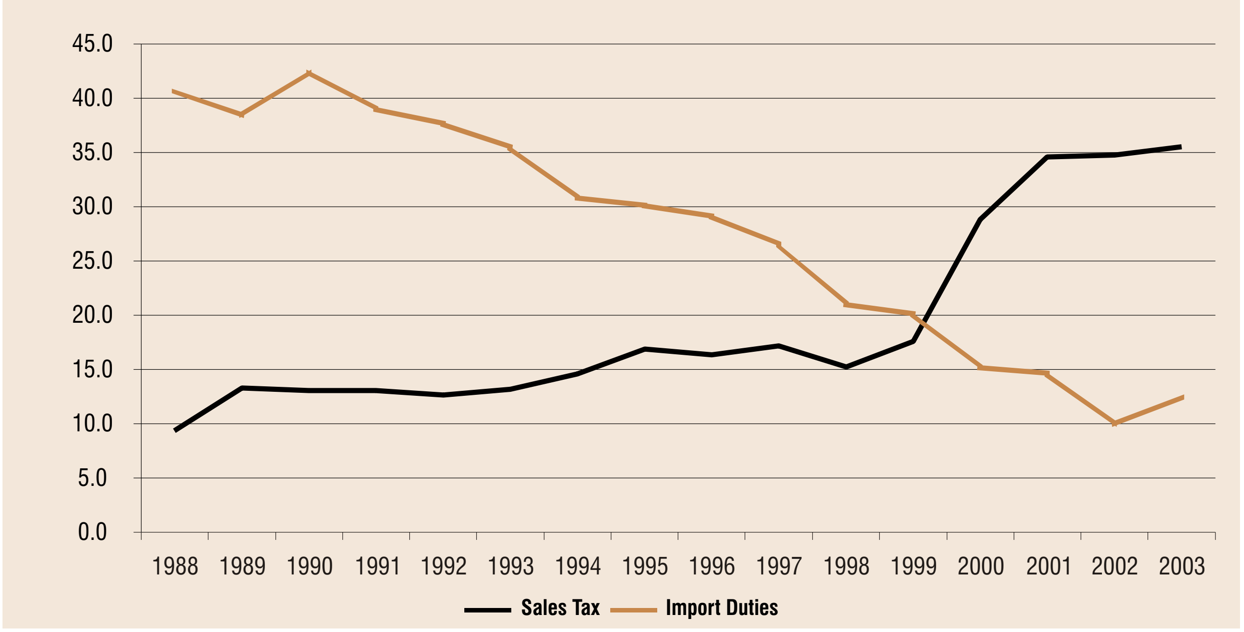


TABLE 9: ANNUAL REAL GROWTH IN EXPENDITURES

Fiscal Years	Education	Health	Public Health	Total
1982	7.8	10.0	14.0	9.3
1983	19.3	7.3	8.3	14.5
1984	5.7	23.7	6.7	9.8
1985	19.8	7.7	-8.4	12.1
1986	33.8	17.8	13.1	27.2
1987	25.7	66.0	40.4	36.2
1988	-8.9	-20.2	17.3	-8.6
1989	-4.2	-5.6	-28.7	-8.5
1990	2.8	2.8	-3.6	2.0
1991	3.4	5.7	45.8	9.0
1992	6.0	-10.0	-9.1	-0.1
1993	1.3	3.3	8.4	2.7
1994	6.6	-2.0	-21.8	0.5
1995	11.1	11.1	6.5	10.5
1996	9.5	9.8	16.5	10.4
1997	-5.1	-3.4	-23.7	-7.0
1998	-2.2	-2.7	10.0	-1.1
1999	-1.8	-4.7	12.8	-0.8
2000	5.4	10.5	-3.1	5.3
2001	-6.8	-2.6	-20.3	-7.5
2002	3.5	6.3	-22.5	1.6
2003	7.0	3.1	-5.9	5.1
Average Growth Rate				
1982-88	14.7	16.0	3.1	14.4
1988-99	1.5	-1.3	2.5	0.7
1999-03	1.5	2.5	-7.8	0.8
Overall	6.3	6.1	2.4	5.6

Source: SPDC estimates

7. THE ROAD AHEAD

Given the situation above, there is currently an urgent need for a strong commitment towards reducing inequality and poverty, and parliamentarians, as elected representatives of the people, can be instrumental in influencing development related policy formulation and budgetary allocations. It is thus imperative that parliamentarians play an effective role in the budget process so that they can influence development allocations towards poverty reduction

Following are some recommendations for a pro-poor budget:

1. The ratio of direct[4] to indirect taxes, which currently stands at about 20:80 needs to shift substantially in favor of direct taxes. The indirect tax burden can be mitigated by reducing the sales tax rate by over half.

2. The share of current expenditure in total expenditure needs to be reduced and that of development expenditure increased substantially.

4. Net of indirect element of withholding taxes

There are 3 major items under the current expenditure heads: debt servicing, public administration and defence. While debt service payments have declined, thanks to the rather generous debt rescheduling, expenditure on public administration can be curtailed by abolishing the federal ministries falling under the Concurrent List. Details of defence expenditure need to be made public, at least of expenditures related to non-combat operations and cuts should be introduced wherever possible.

The amounts thus saved on the above heads need to be transferred to development of infrastructure, housing, education and health. The size of the development budget needs to be 5 percent of GDP at the least, i.e., over Rs. 250 billion (the development expenditure for Budget 2003-04 was at Rs. 160 billion, aprox. 3.6 per cent of GDP). Immediate relief is also in order and can be provided by a meaningful enhancement of the subsidy on wheat. The growing regional imbalances also need to be addressed and special development grants for rural development need to be granted to Sindh and Balochistan.

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