

The budget will be big liability for the future



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Paudyal talked to the veteran economist about the recent budget and its impact on Nepali economy.

What is your overall impression of the new budget?

The budget is very ambitious, as it seems to have been prepared without understanding the ground reality. It also lacks focus as it is a distributive budget.

How does such a distributive budget affect the economy?

The major problem would be its implementation as well as the mobilization of resources. When I talk about mobilization, I talk about financial resources, institutional resources as well as human resources. In terms of financial resources, the budget has projected to increase revenue by 22 percent compared to the revised estimation of the current fiscal year. If the projected growth rate of revenue can't be achieved, it's impossible to mobilize so much resource. Likewise, if you look at other resources, it is dependent on foreign grants and loans worth over Rs 300 billion. Going by previous experience on foreign aid, its utilization is under 60 percent. So based on previous experiences, how much can you expect, may be some Rs 180 billion? So that leaves a deficit of Rs 120 billion when it comes to mobilization of foreign resources.

In total, there could be a deficit of around Rs 250 to 300 billion. In that case, how do we achieve the projected 6.5 percent economic growth? What sector will be the driver of 6.5 percent growth? Is it energy or transport? But infrastructure like road has time lag, though we have to spend now. So, this growth estimation is very ambitious.

When we look at the expenditure side, you have to pay all the salaries and social security allowances. So the question is where will you get that money? Will you cut back on capital expenditure or infrastructure like hydro or transport? That means we are not going to achieve productive capacity.

Likewise, if you look at composition of revenue, it's basically import based. VAT, excise and customs duties are its base. But you claim to make the country self-reliant on the basis of import based revenue target. Moreover, this revenue target will be realized only if the imports grow by over 30 percent. You plan to increase imports and yet you claim that the economy will be self-reliant. This is contradictory.

But hasn't the budget in Nepal historically been more of a political tool rather than an economic tool?

This budget is for me a basically a political statement to influence voters. The real problem of Nepal is low economic growth, poverty and lack of structural transformation. Now we are moving to service sector from agriculture sector. We have started premature deindustrialization. Share of manufacturing sector has declined over the years. Another issue is structural transformation. There are other

activities too which affect the economy: rule of law, effective governance, accountability, transaction cost. These are long term issues and in short term the issue could be implementation of constitution, and reconstruction of earthquake damaged structures.

Likewise, the social security allowance is something to be welcomed, but the way it has been allocated, is it sustainable? Earmarked spending on social security is nearly Rs 100 billion, which is 17 percent of domestic resources. If you distribute some 16-17 percent on allowance, where will you have resources for productive investment?

So the new budget will be a liability for successive governments?

Yes, you are creating a big liability for future government.

What in your view should have been the focus of the budget?

For long-term growth, it should have focused on the structural transformation of the economy. But the immediate priority should have been controlling price. But the big budget will stoke inflation, which in turn could undermine its contribution to social welfare. The average inflation is 9.5 percent. But if you look at commodity prices, daal is up 30 percent plus, the price of rice too has increased by a double digit. The clothing people can buy two or three times a year, but they have to eat every day. The budget should have addressed their daily livelihood concerns.

But isn't it the task of central bank to control inflation through a judicious monetary policy?

If this was a developed country, the monetary policy could have a significant impact on the national economy. But in our case, monetary policy is not competent enough to control inflation. Demand pull (excess demand over supply), cost push (increase in price of labor and raw material) and profit push (increase in wages) are all contributing to inflation in our case. Particularly problematic is profit push inflation resulting from syndicates, cartels and hoarding behavior. The monetary policy can address only demand pull. The government has to address cost push and profit push. On these two factors, I don't see any concrete policy in this budget.

When you talk about structural transformation, how can it be done in Nepal?

In a historical context, an economy is initially near completely based on agriculture, from where it moves towards the development of industry and service sector. This is the path developed economies have taken. In some economies, agriculture and services have underpinned the economy, but the industries still have a role. But in our case, service sector is dominant, and only then come agriculture and industry. The problem is, if there are not enough industries, you can't create enough jobs, nor can you reduce poverty despite economic growth. So the budget should have focused on increasing the contribution of industrial sector. But the government is trying to develop agriculture not by increasing efficiency but through subsidies. Other developed countries also provide subsidy. But can Nepali treasury compete with treasury of India and other developed countries? So the focus should have been increasing productivity and efficiency rather than relying on subsidies. That part is missing in this budget.

The budget has promised 400,000 new jobs. Isn't that possible if reconstruction picks up?

When we are talking about reconstruction, we need an average of Rs 166 billion for each of the next five years. In reconstruction, 70 percent of the money goes to procuring construction material while the rest and 30 percent goes into manpower. Out of Rs 166, around Rs 55 billion is for labour. Is that enough? We also need 250,000 manual laborers. Do we have that kind of labor force in Nepal? Are our youth willing to work in this area? Due to lack of manpower, reconstruction is going to be delayed. Another thing is that the new budget will push up minimum wage, which is going to make Nepal a high-cost economy. That is going to affect our industrial sector.

The budget also talks of free education and health insurance. Aren't these positives?

Of course, spending on social sectors is good. But it would have been even better had the budget also touched upon the quality of health and education services rather than just the quantity.

Are there fundamental differences between the budgets brought by Nepali Congress-led governments compared to the ones brought by CPN-UML-led governments?

The Congress budgets traditionally focus on economic growth and investment on productive sectors. But UML's focus is on social security. Congress budgets also focus on reducing transaction costs but UML budgets do not.

But since a budget is also a political document why can't the government bring it as per its priorities?

I agree. This is UML's budget so it should reflect its political manifesto. But is it sustainable? Is it taking the economy on the right direction? These are key concerns.

How much does this budget support Nepal's graduation process to the developing country, as envisioned by the 14th three year plan, by 2022?

Even if the country graduates now, it will be only technical graduation, not a meaningful one. In graduation, there are three components: human assets, economic vulnerability and income threshold. This budget will not help Nepal achieve the income threshold, which is almost half of the current minimum requirement. When talking about graduation, there should also be inclusion and focus on quality of services. That part is missing.

But the budget does talk about trade diversification and expanding our links with China. How realistic is the hope of greater trade with China and taking advantage of its growth?

This budget talks about implementing the agreements signed with our neighboring countries. It also talks about linking up with the Chinese economy. But the problem is you cannot diversify overall trade. We import meat masala and Banarasi sari from India as the two countries have the same tastes. But can we import these things from China? You can't substitute Indian imports altogether. Also, when we are talking about China, we are basically talking about Tibet not Shanghai or Beijing. Talking about the recent transit agreement and utilizing Chinese ports, where is the nearest Chinese port from Nepal? It is around 4,000km away. So sea transport through China will be hard. Also, sea transport is always cheaper than surface transport. Here if you look at our trade component, we import around 66 percent of our goods from India, 20 percent from China and 25 percent from third countries. So,

altogether, even if we are talking about transit agreement, we are talking about utilizing Chinese route for the 25 percent third-country trade.

Can't we increase third-country trade?

Yes, if we can diversify our exports but for imports it's not that easy. For import substitution, you need to have productive capacity. If we have sufficient infrastructure may be in 10-15 years, we can diversify our economy. And we may be able to then use Chinese route. But currently, and without increasing our productive capacity, we cannot utilize the Chinese facilities.

Looking from historical perspective, what are the chances of next government carrying out the present government's plans and policies?

Historically, 70 percent of the programs and plans are carryovers like Sikta or other priority projects. So the budget will go both into these carryover projects as well as into a few new areas. It aims to raise resources by taking both domestic and foreign loans. Future governments will feel burdened by these loans.