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Comments on Pakistan Economic Survey 2018-19

About IPR

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That the economy this year missed all its targets is no surprise. It has been discussed exhaustively already. It seems that the government too has accepted this fact by changing its economic team a few weeks ago. What is a surprise is that this is still considered news.

For several years, this Institute has warned about the fragile base on which GoP's advertised claims of the last few years, about growth revival and high Forex reserves, were made. Our comments last year said "What is unusual about the economy this year is that its real sector has performed well, while the fundamentals are very weak. Continued weak fundamentals will reduce growth rate and damage the real sector. Also, it will soon affect citizen welfare. The longer Pakistan postpones reforms to arrest the negatives, the worse would be its effect."

In fact, we had been saying so for years. The one new area of weakness this year is tax collection. With economic slowdown, decline in growth of tax revenue was expected. This was accentuated by reduction in direct and indirect taxes, announced last year by the previous government. Yet the extent of shortfall exceeds most calculations, even taking the two factors into consideration.

Below is a recap of the economy's performance during 2018-19. In most years, review of the economy is a story of missed targets. This year is no different. It is surprising that this happens each year and policy makers do not draw a lesson. Sustained economic growth will come with reorienting spending priorities, ensuring economic inclusion, and by investing in and empowering the people of Pakistan. Disregard of this fundamental truth about nation building is what keeps the economy sub-optimal and dependent on others for survival.

Economic Performance 2018-19

The Pakistan Economic Survey 2018-19 sets out how the economy has done this fiscal. This year too, the economy has missed most targets.

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Below is performance against targets approved by the NEC in Annual Plan 2018-19:

- **GDP growth FY 19**: GDP is estimated to grow by 3.29% for fiscal 18-19, missing its admittedly ambitious target for the year of 6.2%. Target and actuals are given in the Table below:

	Target FY 19 %	Actual FY 19 %
GDP growth	***6.2***	***3.29***
Industry	***7.6***	***1.40***
• Manufacturing	7.8	-0.27
• LSM	8.1	**-2.06**
• Mining	3.6	-1.96
• Electricity and Gas Generation and Dist	7.5	**40.54**
• Construction	10.0	-7.57
Agriculture	***3.8***	***0.85***
Crops:	--	**-4.43**
• Important crops	3.0	-6.55
• Other crops	3.5	1.95
• Ginned Cotton	8.9	**-12.74**
Livestock	3.8	4.00
Forestry	8.5	**6.47**
Fishery	1.8	0.79
Commodity producing (Industry + Agriculture)	***5.8***	***1.13***
Services	***6.5***	***4.71***
• Wholesale & Retail	7.8	3.11
• Transport & Communication	4.9	3.34
• Finance & Insurance	7.5	5.14
Source: Targets Annual Plan 2018-19, Actuals PES/National Accounts FY 19		

- **Fiscal Deficit**: For FY 19, the Fiscal Deficit was targeted at 4.9%, against which the he actual is expected to be 7%, though the Economic Survey coyly estimates it to be %. Last fiscal, the actual was 6.6%.

- **GoP Revenue**: FY 19's budget estimated total federal revenue of Rs. 5,660 Billion and FBR tax collection to total Rs. 4,435 Billion. FBR taxes are about 82% of total federal revenue. The new government revised the FBR taxes to Rs. 4,150 Billion. We estimate full year FBR collection to reach Rs. 3,650 Billion. Ten-month actuals were Rs. 2,993 Billion. This is a massive gap of about Rs. 400 to Rs. 500 Billion in resource generation. Clearly, the government's well publicized plans for expanding the tax base was not executed. Nor did it take administrative action to check possible evasion. It has now placed hope in the Asset Recovery/Tax Amnesty scheme, that a large number of non-filers will voluntarily enter the tax net.

  Expanding the tax base entails political cost. Thus far, it is at best work in progress.

- **Balance of Payment:** This year's one achievement is a substantial reduction in the current account balance by 27%. Ten-month actual is USD 11.6 Billion against last year's USD 15.8 Billion for the same period. The current account deficit is estimated to reach USD 14 Billion by end FY 19 against USD 19.897 last fiscal.

  But we may hold the celebration for now. For one, reduction in balance is because of reduced import and not from increase in exports. In fact, ten-months exports have declined YoY, albeit by a very thin margin. Massive devaluation and economic slowdown coupled with a tight monetary policy have reduced imports. However, the most decline in imports is seen in growth inducing machinery imports. Partly, that is the result of the above developments. Partly, that has happened because of maturing of CPEC investment.

  The other cause for concern is that FDI flows have trickled to less than half of the same period last year. Already, Pakistan was dissatisfied with FDI flows. Growth in FDI has been an enduring, though evasive goal for Pakistan. In that perspective this year's radical drop of 56% in FDI is a big blow. Ten-month FDI flows into Pakistan was USD 1,281 million against USD 2,907 Million last fiscal. CPEC investment dwindled and there was loss in business confidence as well as credit worthiness of Pakistan because of the negative news about the economy.

  FY 19 exports is estimated to be USD 23 Billion against a target of USD 28 Billion for the year. Likewise, FDI is estimated to reach USD 1,650 Million against a target of USD 4,145 Million. Both these indicators leave a massive gap in the sustainability of the BoP. Overall, current account deficit will be somewhat more than this year's target of USD 13,300 Million.

  Workers remittance during FY 19 has grown by 8%. By year end it is estimated to be USD 19.3 Billion

Trade Flows July-April FY 19 Million USD			
	July-April FY 19	July-April FY 18	% +/-
Imports	45,471	49,360	-8%
Exports	19,169	19,191	-0.02%
Trade Deficit	26,302	30,169	-13%

Balance of Payment Major Indicators				
	FY 18	July-April FY18	July-April FY19	Change +/-
	Million USD			%
Current Account Balance	-19,987	-15,864	-11,586	-27%
Trade Deficit FOB (incl. Services)	-37892	-30,854	-27151	-13%
Workers' Remittance	19,914	16,482	17,875	8%
FDI	3,372	2,907	1,281	-56%

- **Low savings and investment:**

Low savings and Investment affect growth. Along with low technology content in our production base, this is the most enduring predicament of our economy:

- Investment was 15.4 % of GDP against a target of 17.2 % of GDP. Last year, total investment was 16.7%. Until ten years ago, Pakistan's historical Investment/GDP ratio was 20%. With an Incremental Capital Output Ratio of 4 or more, 20% investment is needed to generate 5% GDP growth.
- National savings has declined to 10.7% of GDP against a target of 13.1%. Domestic savings (i.e. national savings minus remittances) was less than 5% of GDP. In Fy 12, savings was 12%/GDP. It was 14.7% in 2014-15. In 2003-04 it was about 18%. The gap of 6% of GDP between savings and investment is the economy's dependence on external sources. Any increase in investment or overall expenditure brings us close to default.

- **Inflation:**

CPI for July-May FY 19 grew by 7.2%. YoY growth in May 2019 was 9.1%. See Table below:

Inflation: July-May FY 19 and YoY May 19 %				
	Average July-May		YoY May 2019	
	FY 19	FY 18	May 2019	May 2018
CPI	7.19	3.81	9.11	4.19
SPI	4.65	0.78	10.81	0.49
WPI	11.90	3.09	13.99	5.58

Inflation was in check until 2018, based on an artificial Rupee value. SBP decided on an expansionary Monetary Policy. Interest rates declined and money supply grew.

Gradual decline in Rupee value since December 2017 and an expansionary monetary policy put pressure on prices. Inevitably, this pushed the rate of inflation. Year on year CPI in July 2018 rose to 5.8% and WPI to 10.5%. The average for FY 18 was 2.9% and 0.66% respectively.

Overall, economic fundamentals have been weak, a trend that continued and somewhat worsened in FY 19. GDP growth has declined, public debt including external debt has increased, inflation has climbed, and forex reserves is precarious. The only silver lining is an improved current account deficit.

In the last two decades there were two occasions when Pakistan had large fiscal space to build its production base and revive the economy for sustained GDP and export growth. On both occasions, we missed the opportunity. The first was after 9/11, when Pakistan received massive aid and foreign funds from the US and other bilateral and multilateral donors. Along with rescheduling of USD 28 Billion of Paris Club debt for fifteen years, estimates of the total space available to Pakistan was about USD 60 Billion.

The second was during 2015-2018 when along with IMF's Extended Fund Facility, Pakistan received massive Chinese assistance for CPEC. Both times Pakistan did nothing to build competitiveness and exports. On the second occasion we at least built infrastructure, albeit on a lavish scale. During 2001-2007, when most flows were either grant or Coalition Support Fund and concessional multilateral funds, we did not even do that. The energy shortage and the circular debt are products of that decade.

Over many governments, we have repeated the same mistakes. That is why the macro-economic indices forever stay weak. While under an IMF arrangement, we exercise discipline to stay in the programme. Even then more often than not the programmes do not go beyond the first couple of tranche. Space provided by IMF should have been used to institute deep structural reform. During the programme, we test IMF's patience. Once the programme is over, we go back to our ways. In the past, we should have contained spending, chosen infrastructure development carefully to boost exports, and invested in our technical capacity. Reforms of revenue and spending policy (public finance) would have corrected major inequities. That was needed to build competitiveness. We neither stabilized nor built competitiveness. There could not have been a worse use of IMF space and other assistance such as US aid and CPEC finance.

We are again close to finalizing another arrangement with IMF. A staff level agreement has been finalized (yet to be ratified by the IMF Executive Board). This is a three year (39 months) Extended Fund Facility with the IMF. The tight monetary policy and adjustments in Rupee value and in utility tariffs have spurred inflation and have dampened investment plans. Inevitably, growth has fallen and will remain so for a couple of years. The discipline being imposed by IMF was much needed. The test lies in what the government does once the arrangement ends and whether it has the foresight and the willingness to correct the economy's structural flaws. We have to move from a crony and elite economy to an efficient dispensation. The future of the economy rests on that decision.

There are some signs of improvement, though it is to be seen if the measures are sustained. GoP claims to have reduced revenue leakage in the power sector. If successfully done, this will mitigate the circular debt to an extent. With considerable tariff increase in power and gas sectors, GoP hopes to recover fully their cost and restore financial order to the sector. However, all this is yet to be seen. Meanwhile, circular debt continues to grow.

PSDP spending received a large cut during 2018-19. The process began during the caretaker government and has continued since. The Rupee PSDP budget for FY 18 was Rs. 838 Billion. For FY 19, the revised Rupee PSDP budget is Rs. 530 Billion. Until end May 2019, PSDP Rupee releases were Rs. 395 Billion as compared to Rupee release of almost Rs. 600 Billion in FY 18. Such large cut in PSDP has had an effect on growth.

Public debt including external debt grew rapidly, as in the past years. Resultantly, debt servicing has taken an increasing share in expenditure.

Summarized Fiscal Operations					
	July-March FY 19	July-March FY 18	% +/-	July-June FY 18	% Share in total Of total expenditure
Total	**3,655**	**3,189**	**14.6**	**4,704**	**100.0**
Current	**3,202**	**2,671**	**19.8**	**3,814**	**87.6**
Defence	-775	-624	24.2	-1,030	21.2
Debt servicing	-1,459	-1,173	24.4	-1,500	39.9
Pensions, grants, others	-731	-651	12.2	-961	20.0
Sub-Total of above 3	-2,965	-2,448	21.1	-3,491	81.1
Balance for civil government	237	183	29.5	323	6.5 (8.4 of current)
PSDP	**408**	**478**		**789**	**13.5**
Federal Revenue	**3,243**	**3,186**	**1.8%**	**4,696**	
Fiscal Deficit	5.0%	4.3%		6.6%	

Effect on fiscal deficit from uncontrolled growth in expenditure in recent years were kept in check because of several years of double-digit growth in revenue, especially FBR taxes. This year, federal revenue has barely grown (1.8%), while total expenditure increased by 14.6% (current by almost 20%). Consequently July-March FY 19 fiscal deficit was 5% compared to 4.3% for the same period last fiscal.

Against an increase of 1.8%, revenue this year should have grown by about 10%. Over 7% CPI increase for July-May FY 19 and 3.3% GDP growth.

As in past years, government this year too has not addressed the issue of PSE losses. Each year, this is a major drain on GoP resources. While taxpayers are rightly being asked to fulfill their responsibilities as citizens and pay the taxes due, government has yet to show strong urgency in creating expenditure efficiencies. Unrestrained PSE losses is money that could go to development, security, or to improve service provision to the people. Plans for strong action have been have afoot, but so far, there is nothing on ground. Subsidy for PSEs are a particular concern. Despite claims to contrary, government has done very little, if at all, to restructure and turn around PSEs or to privatize them. Accumulated PSEs losses are routinely estimated to be between Rs. 1.2 to 1.4 Trillion. The numbers were estimated in 2018 by IMF. Government has not clearly disclosed PSE losses.

Not much of government spending is for stimulating growth or adds to public welfare. During July-March FY 19, PSDP spending was a paltry 13.5% of total expenditure. Debt servicing and defence had a share of 61% in total expenditure. Add to it grants, subsidy, and pensions and their combined share is 81% of total. The pace of growth of debt servicing is formidable and a cause of concern. From almost 40% this year, next year it may grow close to 50% next fiscal. We cannot have a prudent fiscal policy at this scale.

Public Debt

High fiscal deficit over many years and an unprecedented one, approaching 7% this year, means that government has continued to incur debt.

Total debt and liabilities stood at over Rs. 35 Trillion or over 91% of GDP. Debt and liabilities have grown by 17.5% from the debt stock on 30 June 2018, adding Rs. 5.2 Trillion to the total. Domestic has grown by 11.8% and external debt by 23.3% (this includes also the effect of a devalued Rupee). External debt alone is now 35% of GDP.

Measured in dollars, external debt has grown in double digits. Total debt and liabilities stood at USD 105.8 Billion end March 2019, compared to USD 95.1 Billion in June 2018, up over 11%.

A startling development in recent years is slowdown in concessional debt and radical increase in commercial debt, a growth of 800%. The increase in market-based debt with limited tenure and high cost was a great factor in causing fragility in the economy. See Table 4, Bonds, Sukuk, commercial.

All debt sustainability indicators worsened. The economy’s debt bearing capacity (measured as Debt/GDP) was fragile. Public debt to GDP increased to 85.8%, along with liabilities it was 91.2%. Average maturity of debt declined from 21 years in 2010 to 11 years in 2018. The added risk to the economy and increase in debt servicing carried the potential to affect growth.

Pakistan Total Debt and Liabilities

Billion Rs.

		June 2007	June 2013	June 2018	March 2019	Growth March 2019/June 18
Total Debt and Liabilities		**5,024**	**16,228**	**29,861**	**35,095**	**17.5%** **91.2% of GDP** **+ 5,234 B**
Domestic Debt		**2,597**	**9,833**	**17,483**	**19,549**	**11.8%** **+ 2,066**
	Government	*2,597*	*9,521*	*16,415*	*18,170*	*10.7%* *+1,755*
	PSEs	--	*312*	*1,068*	*1,378*	*29.0%* *+310*
External Debt		**2,341**	**5,698**	**10,935**	**13,478**	**23.3%** **+2,543**
	Government	*2,135*	*4,311*	*7,795*	*9,626*	*23.5%*
	IMF	*85*	*435*	*741*	*811*	*9.4%*
	PSEs & Private incl intercompany	*121*	*952*	*2,399*	*3,041*	*26.7%*
Total Debt		**4,935**	**15,531**	**28,418**	**33,027**	**16.2%** **+4,609**
Liabilities		**89**	**697**	**1,442**	**2,068**	**43.4%**
	Domestic	--	*470*	*820*	*654*	*-21%*
	External	*89*	*227*	*622*	*1,414*	*127%*

Table 4: Pakistan External Debt and Liabilities
Billion USD

		June 2007	June 2013	June 2018	March 2019	March 2018	Change USD/ %
Public Debt + Forex Liabilities		**36.7**	**50.2**	**75.4**	**84.2**	**73.0**	**11.2 15.3%**
•	• *Multilateral and concessional bilateral*	32.5	44.2	53.6	61.3	52.2	9.1 17.4
	• *Bonds, Sukuks, commercial*	2.8	1.6	14.1	16.1	12.8	3.3 25.8%
	• *Short-term debt*	0	0	1.6	1.1	1.7	-0.6 -36%
	• *IMF*	1.4	4.4	6.1	5.7	6.3	-0.6 -10%
Private debt		**2.0**	**6.8**	**15.8**	**18.4**	**15.9**	**2.5 15.7%**
Total External Debt + Guaranteed Liabilities		**38.7**	**57.0**	**91.2**	**102.6**	**88.9**	**13.7 15.4%**

Forex Liabilities non-guaranteed	**1.5**	**2.8**	**3.9**	**3.2**	**3.4**	**-0.2**
Total Ext Debt & Liabilities	**40.2**	**59.8**	**95.1**	**105.8**	**92.3**	**12.5 14.6%**