



Budget 2021: Stability, Revival, or Managing Crisis

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This report is a summary of an online panel discussion held by IPR on 3 June 2020. The speakers were:

- *Mr. Sartaj Aziz, Former Finance Minister*
- *Dr. Muhammad Zubair Khan, Economic Policy Expert*
- *Mr. Humayun Akhtar Khan, CEO & Chairperson IPR*
- *Dr. Faisal Bari, Professor of Economics, LUMS*
- *Mr. Ehsan Malik, CEO Pakistan Business Council*

Moderator Ashraf M. Hayat, IPR

Introduction:

The whole world is consumed by the pandemic. It's human and economic cost, and how governments respond, will shape the world we live in for the coming years. As most people think of the future, the one thought that comes to mind above everything else, is uncertainty and precariousness. Our lives have been upended by the virus, people feel insecure about their health, their loved ones, their jobs and income. In such perilous times, people turn towards

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the government for comfort, relief, and reassurance. In this environment, the Government of Pakistan (GoP) has the unenviable task of preparing the coming budget. IPR hopes this budget is prepared with empathy and by putting people first.

Mr. Sartaj Aziz**Observations:****Board of Advisors**

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- The entire human race is in a state of panic and uncertainty. The economic consequences of this pandemic are going to last much longer and could change the very nature of economic activity that we are used to undertake.
- Unfortunately for Pakistan, the economy was already in dire straits even before COVID-19 appeared. Pakistan's growth rate which was 5.8% in FY 2017-2018, had gone down to 1.9% in FY 2018-2019, and this year the forecast was only 2.4%. The rate of inflation had also gone up from 4% to 12%. Exports were almost stagnant and revenue collection posted negative growth for the first time in 51 years.

- After the emergence of COVID-19 pandemic, these dire economic fundamentals have further deteriorated. Pakistan may for the first time, may see negative, -6% growth rate.
- This will lead to further large scale unemployment across Pakistan and will hit the country like a thunderbolt. The estimate of unemployment today is over 20% and may go as high as 30%. That will add 20 million unemployed breadwinners. This unprecedented jump will have a huge impact on poverty. Even before the pandemic, 28% of the population was already living below the poverty line. That is 63 million people and about 10 million households.
- In terms of economic revival, the most important sector is agriculture. It is not only labour intensive, it accounts for 19-20% of the GDP but provides jobs to 40% of the population. It also has an important role in controlling inflation and in exports. It is also easier to enforce COVID-19 standard operating procedures (SOPs) in the agriculture sector, as compared to other economic sectors.
- The construction sector needs special attention. A package has been announced for the construction sector but two constraints still remain. First, the inefficient and corrupt system of land transfer and building control which adversely affects this sector. Second, the cost of credit being offered to the construction sector.
- Another important sector that has been affected, is Small and Medium-sized Enterprises (SMEs). It is a very important labor intensive sector. For example, small-scale manufacturing employs almost twice as many people (5.5 million) compared to large-scale manufacturing which employs three million. Yet, the small-scale only gets 2% of the credit.
- Lastly, another essential sector is trade. The services sector is 60% of the GDP and one third is trade; wholesale and retail trade. It employs almost 10 million people, 15% of the labor force, and this sector has been seriously affected by the COVID-19 pandemic.

Recommendations:

- Poverty and unemployment are inter-related and closely related to economic revival; in both formal and informal sector. Therefore, these two problems should be the main focus of the budget. Many sub sectors of the economy such as traveling, transportation, tourism, sports, and entertainment sectors will require many years to regain the pre-Covid-19 level of economic activity.
- These problems cannot be resolved through ad-hoc measures. What the country needs is a coherent post-Covid-19 economic revival plan. A short-run plan for one year, and a medium-run plan which will focus on the next three years. This will require a comprehensive approach, both through financial and non-financial measures.
- All duties and taxes, which raise the cost of production should be brought down. Since output prices are likely to decrease because of low oil prices and lower demand. Therefore, the input prices need to be reduced.
- Enhancement of agriculture credit and reduced and reasonable interest rates. If the overall interest rate is brought down to 6% instead of 8%, agriculture credit can be made available at 8-9% rather than 14-16 % that is currently being offered.
- The government must invest in water management and conservation, particularly for enhancing the productivity of water.
- Pakistan should move towards high value agriculture such as livestock and horticulture and also from chemical to organic and natural agriculture. We must also pay special attention towards cotton. This crop has greatly suffered and our textile industry is highly dependent on it.

- State Bank of Pakistan should offer an economic relief package for SMEs so that they are able to retain their workers.
- Pakistan should now move away from the stabilization policies under the IMF to a growth-oriented policies and the size of the Public Sector Development Programme (PSDP) is a very important element for implementing a growth-oriented policy. A minimum of Rs 800 billion should be allocated to the PSDP. Pakistan can borrow money from new financial institutions such as BRICS and AIIB.

Dr. Muhammad Zubair Khan

Observations:

- Pakistan's main macro-economic issue has been the persistent and high fiscal deficit. This has led to very high debt, which continues to rise. Pakistan's fiscal situation is not sustainable.
- There are a number of issues that contribute to this. It is not just the primary deficit; it is also the high interest rates compared to the growth rate. Pakistan had not made any adjustment even after the adoption of the IMF programme. Pakistan's economy was already in a bad state. Now after the pandemic Pakistan's economy has plunged further.
- Pakistan had adopted an interest rate policy which was totally detrimental to the economy. It has cost Pakistan nearly Rs 3 trillion in the budget on interest payments alone. This has had an extremely adverse impact on the private sector which slowed down the economy to 2% before the pandemic occurred. Now with pandemic and the lockdown, the GDP will definitely go the negative area around 1 or 2% which will cause massive unemployment and poverty.

- Pakistan was also facing economic difficulties because of its tax-regime. It is a well-known fact that for 10-15 years the emphasis has been only on revenue generation. Tax policies have to look at not just the revenue impact but the economic impact of taxes, which Pakistan has continued to ignore.
- It is not an accident that Pakistan exports have stagnated for the last ten years and our industry and manufacturing industry has been contracting. Pakistan's continued reliance on import substitution despite the usual rhetoric that Pakistan is export promoting. This is not indicated by our tariff regime. Pakistan also had exchange rate policy which was distorted and kept the exchange rate fixed for too long.
- Pakistan did adjust the exchange rate, but failed to make a fiscal adjustment. Instead, the government at the behest of the IMF adopted a high interest rate policy.

Recommendations:

- The country can ill afford to impose any more taxes. Pakistan needs to not only stop imposing new taxes but also change the taxation policy and allow the private sector to breathe.
- Pakistan can no longer sustain a large government. It is high time to cut down the number of government officials. Therefore, it is imperative to cut down on the size of government.
- The best thing to do for the poor is to generate employment and not give out cash-handouts, as it sets a bad precedent and is not affordable in the long run.
- The economy needs to keep on going, to get people back to work with the proper SOP's being followed. COVID-19 is here to stay, and we will have to learn to live with it.

Mr. Humayun Akhtar Khan

Observations:

- Fifty years of focus on stability and austerity has left us with no long-term strategy. What the country needs is a strategy for economic development but it gets each year a sad news, especially for the voiceless. The scale of the present crisis will force the government to rethink its role and the government must shed years of apathy in policymaking.
- The pandemic poses many challenges for us, but one benefit it could bring, is a wake-up our policymakers. Hopefully, the upcoming budget will reflect this shift by putting people first.
- On the surface, the pandemic is a health problem, in reality it is about quality of governance and institutions. The inability to control its effect is a test of leadership. Knowing as we do the serious crossroads at which the world stands today, it is surprising that there is no national debate on what may be in store for Pakistan.
- There is a major recession taking place in the world, we are seeing a global squeeze on liquidity, worse than 2008 financial crisis. And today, we see a world without a global leader. Which is why it is critical for Pakistan to do everything possible in the best interest of the country and its critical that we take strategic stock if where we stand on many indicators of a dynamic society.
- It is imperative that the upcoming budget serve as a response by the government to the challenges posed by the pandemic. It should prioritize activities that reduces the economic and health cost of the crisis, which saves lives yet keeps our economic system running.
- In addition to the recession, this budget is being made in the shadow of many negative developments. We are in a worrying stage of the pandemic with rapid rise in cases and no

clear strategy to contain or suppress it.

- Foreign exchange is scarce. Our exports have been in decline for some years. Fall in worker's remittances is also imminent and a lot of foreign exchange, the 'hot money' has left the country. While FDI and private inflows are unlikely.
- GOP revenue is falling in real terms, though July-March federal revenue grew by 33% thanks to SBP profits. However, it is bound to fall now as the recession sets in. If we do not get a major debt relief, Rs. 2.5 Trillion will go to debt servicing in FY 20. Next fiscal, it will be even more. This takes away about half the budget. In addition, we are still bound by IMF targets under the EFF.
- Therefore, the government has some tough choices to make. On the one hand, health expenses and supports to the firms and jobless people is critical. On the other, while some breach of targets agreed with IMF is possible, there will be no free ride.
- In addition, there are some framework issues with respect to budget making. The economic policy making is a top level responsibility for elected officials. Years of outsourcing of decision-making has not worked. Because people turn to elected leaders when they suffer.

Recommendations:

- The coming federal and provincial budgets must therefore focus on the health expenditure to contain and suppress the virus. Funds need to be allocated for Personal Protection Equipment for health workers, for testing and tracing, isolation units and more ICU ventilators.
- Provide welfare to those who have lost jobs, even if we lift the lockdown, demand will not revive at once. Direct transfers must continue.

- We must keep the economy alive. Ministry of Finance and SBP must be aggressive in helping firms. SBP has already announced a number of schemes to prevent layoffs and relief for businesses. They must do so generously without conditions.
- Most SMEs and micro enterprises are in the informal sector and cannot avail bank loans. The government must reach out to help such firms as we cannot afford to let them sink. They hire the bulk of workers and supply goods and services to other firms.
- Businesses large and small must receive concessional working capital. We must prevent large-scale closure of firms or job losses so that economy revives as demand picks up.
- To manage the current account, GoP must prioritize imports for businesses over those for consumption.
- Government must review federal and provincial PSDPs. It may put other projects on hold to spend more on health and services for the people and businesses.
- After the crisis, the government must launch a growth plan. Macro stabilization is not an end itself, it must stimulate GDP growth to improve living standards of the people.
- Today there is nothing more important than the lives of Pakistanis and survival of our firms. This should be our clearly stated goal and is critical if the economy is to come out of the crisis without a deep scar, it is important to put the effect of the pandemic behind us as soon as possible. If we ensure that, it is possible we will see a sharp recovery.
- We must stop external borrowing for budget support. The payment of interest and foreign loans is a transfer of resources to other countries. Foreign loans should only be acquired to build exports, which will help repay the loans.
- It is critical that we encourage savings inside Pakistan. The constant decline in the savings rate is a huge concern.

Dr. Faisal Bari

Observations:

- A lot of the reforms that the government needs to go through are at the micro level and not just the macro level. Property rights regimes, regulatory structures, structures of contract, issues of market and management require a lot of work on an urgent basis.
- The problem with Pakistan's previous attempts at economic reforms is focusing too much on the macro side. The micro work, which is much more detailed, but equally important, gets neglected.
- Pakistan has over 20 million out of school children. It shows that we have a huge problem of under investment in education.
- This is not a problem of not just having the resources, but it is because of misplaced priorities. Instead of investing in hospitals or schools, the country has been building underpasses and bypasses.
- The recession has created a tremendous pressure on a number of private schools, especially the lower price ones. Many private school schools are going to struggle to stay open. Even universities are under tremendous pressure, both private and public.
- Closure of schools are going to cause learning losses, increase drop-out rates. It will further worsen differential impact on the poor, girls, and on rural children as compared to urban children.
- The inequalities that have been built into the system are going to get exacerbated by the COVID-19 pressure.

Recommendations:

- The government needs to be prepared for the recession's impact on enrollment as well as achievement, after the schools open for the fall period.
- The issues in education and health are deeper, more longer-term and require much more sustained effort. For that the budget can make a start but that will require a major restructuring, rethinking and reorientation. Also, most importantly, re-prioritization of expenditure.
- We will hear talk about reforms, but there is not much hope that we will see reforms.

Mr. Ehsan Malik

Observations:

- Even before the COVID-19 pandemic hit Pakistan, industry in Pakistan was on the way down.
- Pakistan was prematurely de-industrializing each year, and its representation in the GDP was declining. There is a long term trend and a long term relationship between the rate of manufacturing growth and the rate of GDP growth. Each of the years when the manufacturing goes down, surely, GDP follows suit.
- Pakistan's exports share was down as compared to Bangladesh since the past 15 years. Theirs have doubled and Pakistan's has reduced significantly.

- The rate of investment in the country as a percent of GDP has also been declining and the latest feel is no different.
- Pakistan had a hugely pro-import fiscal policy and the government did not enforce any cascading import tariffs.

Recommendations:

- We need to find a way to turn this crisis into an opportunity. This would be an unfortunate crisis wastage if all the political parties don't get together.
- We need a national economic plan, which should be formulated with consensus across the board. The same way the country got together during the National Action Plan and defeated the menace of terrorism.
- These are extraordinary times and it is not business as usual. The country was barely out of an economic crisis but now due to the pandemic we are deeper into that. Therefore, political consensus and national unity is the need of the hour.
- In the current situation, it can be expected from the IMF to offer some relaxation as many other countries have also approached it and the found some latitude. Pakistan may also find some concession.
- The budget needs to be very focused and targeted. We need to identify what are the sectors and where geographically should the major thrust of the economic revival occur. In this regard, the agriculture sector will hold great importance as 60% of the population resides in the rural area. Luckily, they have been the least affected today by pandemic as of yet.

- Locust infestation is yet another crisis, which can threaten our food security so the government must make preparations to tackle this upcoming threat.
- The bulk of the benefits from the budget needs to come to the cities, the urban areas and to the people who work in these industries.
- Relief should be given the common man, who are most affected by this pandemic and are suffering unemployment.