

Policy Review

FEDERAL BUDGET

2020 - 2021

4LS
Lives
Livelihoods
Lockdown
Locust



SDPI

Sustainable Development Policy Institute

CONTENTS

1. Budget 2020-21: On the cusp between needs and resources

By Dr Abid Qaiyum Suleri

2. Budget 2020-21: A macroeconomic overview

Dr Vaqar Ahmed

3. Budget 2020-21: Pakistan needs a new fiscal policy

Dr Sajid Amin Javed

4. A post-budget review of Pakistan's power sector

Ahad Nazir

5. Rethinking economic paradigm after COVID-19

By Dr Vaqar Ahmed

Budget 2020-21

On the cusp between needs & resources

In next 12 months, we will have to deal with four Ls (lives, livelihoods, lockdown and locust) along with four Ds (debt servicing, defence, day-to-day administration, and development

Dr Abid Qaiyum Suleri

Though the federal budget 2020-21 has no big bang announcements to bring laurels for the people of Pakistan, the government has tried to put the country's needs and resources on the cusp between income generation and overall spending paving the way for a smooth operationalization of economy. Amid COVID-19 pandemic and locust attacks on the already fragile economy alongside impending fears of floods, droughts and heatwaves, the task of preparing the federal budget 2020-21 was quite complicated and gigantic.

On the needs side, the current budget has four Ds, i.e. debt servicing, defence, day-to-day administration, and development whereas on the resources side, it has two ingredients, i.e. federal revenues (generated both from tax collection and non-tax income) and borrowings (taken from domestic banks as well as bilateral and multilateral foreign lenders). Since the needs always outrun resources, therefore, the makers of Pakistan's budget are in continuous struggle to match the two.

What makes this complicated task even more complex is the situation that arises out of borrowing from the International Monetary Fund (IMF). It is always directly linked to budgetary indicators such as tax collection, inflation, interest rate and currency value. Whenever Pakistan receives financial assistance

from IMF, as it is getting now, the making of the budget starts with the setting of a target for fiscal deficit - the gap between revenue and expenditure. Often, the revenue gets inflated and the expenditure is deflated in such a way that the imbalance between the two does not exceed an IMF-mandated deficit target. Of course, a country has to compromise its financial sovereignty in such a situation.

Apart from all these challenges, the economic and financial impact of coronavirus has been so widespread across Pakistan's political economy that policymakers have termed the Budget 2020-21 as the one concerned more with 'survival' than with 'growth'. In the coming 12 months, we will have to deal with four Ls (lives, livelihoods, lockdown and locust) along with four Ds as mentioned above.

The government too is aware of the fact that it cannot overlook or undermine the importance of these factors. The latest edition of the Pakistan Economic Survey released a day earlier the announcement of the budget, contains a section titled: 'COVID-19 Advent and Impact Assessment', which talks about the loss of lives and jobs, decline in revenue and export targets, and slump in growth rate. Keeping in view all these misfortunes, there is a need to draw a brief outline for the future course of action.

As of the third week of June, the COVID-19 cases in Pakistan have reached over 150,000 with a daily average of staggering 5000 cases in the first 15 days of the current month. This can rise further as the spread of the disease has not peaked yet. Even before the peak is reached, Pakistan's health infrastructure begins to creak under the strain. The budget, therefore, needs to allocate enough resources to improve this infrastructure so that it might effectively handle the medical impact of corona pandemic.

It is important to note here that the country's health facilities were far less than adequate even pre-COVID-19 period. For instance, only one hospital bed was available for more than 1,680 people; this ratio needs to be improved. Though health is a provincial subject after the passage of 18th constitutional amendment, a whole-hearted response of the Centre towards provinces in this regard would be a sign of morale booster. In this budget, the government's commitment to win Universal Health Coverage with its focus on health reforms and preparedness for COVID-19 is more of a ray of hope. These reforms should be designed keeping in view the survival of the poor and vulnerable communities drenched in poverty and their implementation at primary, secondary and tertiary levels. Above all, a national package for the safety, security and health of our frontline workers, including doctors, nurses and paramedics and hospital staff, needs immediate attention of the government.

Besides, the government needs to ensure that child immunization campaigns, which have been halted due to COVID-19, are resumed. The current level of immunization - 66 per cent

of all children in the country - is too low to be effective against the scourges such as polio.

The economic effect of COVID-19 has been as harmful as its health impact. It has directly threatened the livelihoods of 27.3 million informal labour engaged in non-agricultural sector in addition to 22 million agriculture workers. A study by the Sustainable Development Policy Institute (SDPI) shows that one million Small and Medium Enterprises (SMEs) may not survive if they are forced to remain closed for more than one month without any government assistance. In any case, the chances that the benefits of the government's business relief package will reach them remain slim because 3.25 million SMEs in the country are not documented, and thus are ineligible to receive any pandemic-related financial assistance. The budget needs to do something to mitigate the loss of such livelihood opportunities.

A corona-related lockdown on business activities has also caused an immediate dip in revenue generation. In the months of March and April each, the Federal Board of Revenue (FBR) collected 13.4 per cent less taxes than it did in the previous months. That's why the balance between giving incentives to businesses to remain open and making them pay taxes becomes really difficult to maintain. Though the government has abolished Rs 40-50 billion duties apart from providing relief in duties and taxes, laws need to be amended to facilitate businesses as well as ease of doing business.

Another important task at the hands of budget-makers is to help 42 million students to overcome the loss of time and education they got incurred as a result of smart lockdown. This loss can be covered by providing them an

access to high-speed internet at preferential prices and make lectures and notes available to them through online and offline digital means. Some mechanism on the lines of Benazir Income Support Programme (BISP) must be devised to provide financial and technological assistance to these students on urgent basis.

The list of COVID-induced economic and social detriments can go on forever, but immediate attention should be focused on the essential ingredients of the government's 'survival' budget.

Let's move to another threat Pakistan is facing while most of the world states do not have to contend with, i.e. the locust attack.

A swarm of desert locusts in millions have attacked 51 districts of Pakistan, hurting the country's economy in general and agriculture in particular. According to some latest estimates, if controlled successfully, locust attack will inflict Rs 250 billion loss in the fiscal 2020-21, and if not the loss may escalate to Rs 1 trillion. This means the next budget needs to allocate sufficient amount and resources to respond to the locust attack so as to avert such a massive loss. To summarize all that goes above, Pakistan is facing a situation where the needs sides of its budget-making exercise is expanding whereas the indigenous part of the resources side is shrinking.

That's why, the external part of resources side becomes extremely important. As Pakistan is already receiving IMF's financial assistance, no budget can be finalized without its input and approval. Since there is a big drop in revenue collection in March and April this year, Pakistan tried - unsuccessfully -- to convince the IMF that the tax collection target for 2020-21 should be set at Rs 4,500 billion and fiscal deficit should

be allowed to remain the same as for the financial year 2019-20, i.e. around 9 per cent of the Gross Domestic Product (GDP). IMF, however, asked the revenue collectors to aim high. It has, however, given the signal that it could be flexible in its targets to accommodate fiscal slippages caused by non-policy factors such as COVID-19 and locusts. At the same time, the Fund has made it clear that the deficit will not be allowed to increase due to non-developmental spending on such things as energy sector's circular debt, loss-making public sector enterprises and increase in salaries and pensions.

Seen in this context, the tax revenue target for the fiscal 2020-21 being set at Rs5,464 billion appears too high to be achieved. Given that the government could not achieve even its reduced tax collection target for the fiscal 2019-20, the same is expected in this coming year.

It means the government will have to rely on more borrowing from both domestic and external sources. Some of the numbers carried in the budget 2020-21 documents show how much borrowing the government will require in the coming fiscal year. For instance, even if the government meets its highly ambitious revenue target, it will be left with Rs 3,700 billion after giving provinces their share under the National Finance Commission (NFC) award. Compare this with the spending the government has to make in any case over the next 12 months, i.e. Rs 2946 billion for debt servicing, Rs 1289 billion for defence, Rs 480 billion for civil and military pensions and Rs 476 billion for running the civil administration. Even if the government does not spend a single penny on public sector development programme, it will have to

borrow at least Rs 3,000 billion in the next fiscal year.

It is extremely important that the government expands, rather than contracts, its development programme and other social protection facilities so as to help people, businesses and communities get over the negative impact of COVID-19. To address these issues, the government has included Rs 1,200 billion stimulus package that Prime Minister Imran Khan announced in April this year in the budgetary allocation. It has also increased the allocation for BISP - renamed as Ehsaas - to Rs 200 billion and has earmarked Rs 70 billion specifically for the COVID response.

The government must make a considerably upward revision in the development expenditures. Besides, it should allocate more money to fight off both coronavirus and locust attack. It should similarly focus on ensuring food security. This is the only thing that can protect the country from falling into an anarchic-like situation. Though the government has already announced Rs 100 billion farm package with the intention to launch Rs 290 billion National Agriculture Emergency program for five years in coordination with the provinces, there is a need to build political consensus.

Information and Communication Technology is another area of paramount importance that needs to be expanded. Post-COVID era would require to invest in digitalization especially for the developing economies like Pakistan so that we might embark upon fourth industrial revolution. There is a need to prioritize the establishment of virtual education system so that our students in remote areas can continue their education and take their examinations remotely. Likewise, there is a need to increase

the higher education budget to improve the quality of education and synchronize it with the international research and curricula activities.

This can be achieved by increasing monetary allocations for scientific research by strengthening R & D organizations in the country particularly in agriculture so that crops, vegetables, and fruits resistance to climate change and pestilence could be developed on urgent basis.

Last but not least, the austerity and reduction in unnecessary expenditures need to be ensured at all costs. The proposals of the task force on austerity and reform regarding privatization of at least 43 institutions, abolition of eight non-functional departments, devolution of 14 offices to the provinces and merger of 35 with other institutions should be taken up as serious as the issues of health and economy. This restructuring would herald a new governance model and tantamount to a significant reduction in fiscal burden on the Centre.

All this, however, does not require a massive policy shift.

Since we have been financing four Ds through borrowing for decades, we only need some more borrowing to finance four Ls. This will certainly have its economic and financial implications but it will be a future investment - not a dead expenditure on building more office space and recruiting more officials.

Done correctly, this investment can help us generate surpluses in the future. Time is ripe to make this important decision.

Budget 2020-21

A macroeconomic overview

Dr Vaqar Ahmed

A. COVID-19 and Macroeconomy

The COVID-19 pandemic is expected to bring about sharp economic contraction. Pakistan's economy which was already at a low growth equilibrium was expected to grow at 2.4% during fiscal year 2019-20 (FY20). This rate of economic expansion is now expected to contract by -0.4% and a slower recovery with real GDP expected to expand by 2% in FY21.¹

The 9-month data on large-scale manufacturing indicates a 5.4% contraction. A significant slowdown is now visible in textile, petroleum products, automobiles, chemicals, leather, iron and steel products, metallic and non-metallic metals, and electronics. The agriculture sector will also contract due to the delayed harvesting this season on account of lockdown and locusts attack. The output in productive sectors of the economy, particularly manufacturing industries, has been hit hard via four main channels.

First, the supply side channel indicates that disruptions in supply chains and constraints imposed due to COVID-19 on international and local movement of industrial inputs have resulted in lower than expected production.

The Small and Medium Enterprise Development Authority (SMEDA) survey reveals that 92% of firms have reported a disruption in their supply chain and 23% have reported up to

100% loss in their export orders.² The micro, small, and medium enterprises are particularly vulnerable. It is likely that in the event of a prolonged lockdown, several industries could see firms laying off their workers.

Second, the demand side channel indicates that lower orders for goods and services currently and in future months will translate into lower earnings.³ The fears of layoffs have also triggered lower household-level demand for goods and services in FY20, and a preference for savings, or shifting of expenditures in favour of healthcare and essential needs. In the agriculture and livestock sector, weak purchasing power is resulting in farmers not investing in next seasons inputs, which could ultimately threaten food security.

As government cuts back on its capital investment and spends to cover for healthcare and social safety nets, the public sector's investment to GDP ratio is also expected to decline from a pre-COVID-19 level of 3.3% to 2.3%. This also points towards a very tight fiscal space to sustain current levels of stimulus over the next fiscal year.

¹ IMF Country Report No. 19/380.

² SMEDA's Survey on Impact of Covid-19 (Coronavirus) on SMEs. Accessed via web: <https://tinyurl.com/ycy8ow9a>.

³ See for example: Ahmed, Vaqar and O'Donoghue, Cathal, (2010), External Shocks in a Small Open Economy: A CGE - Microsimulation Analysis, Lahore Journal of Economics, 15, issue 1, p. 45-90.

Third, the financial market channel shows that lower confidence and reduced earnings by both firms and people have adversely impacted markets for financial instruments (including stock markets and foreign exchange markets). Pakistani rupee saw a sharp decline in April before getting stabilized due to \$ 200 million investment by foreign investors in

reduced mobility of Pakistani goods and people abroad.⁴

The investment outlook remains weak and uncertain. As Pakistan's economy gets affected due to the above-mentioned transmission mechanisms, fixed investment to GDP ratio was 13.8% in FY 20 According to the projections (Table 1), it is expected to fall further in FY21.

Table 1: Pakistan Macroeconomic Profile

Indicators	2019-20	2019-20	2020-21
	Pre-COVID	Revised	Projections
Real GDP growth (%)	2.4	-0.4	2.0
Fixed investment (as per cent of GDP)	13.2	13.8	11.4
Public investment (as per cent of GDP)	3.3	3.8	2.7
Inflation (CPI, Period Average, Growth %)	11.8	11.2	8.0
Government revenue (per cent of GDP)	16.0	16.9 (B.E)	15.8
Government expenditure (per cent of GDP)	23.2	24.4 (B.E)	22.3
Budget deficit (percent of GDP)	7.2	7.5	6.5
Primary deficit (percent of GDP)	0.8	0.9	0.4
General government debt (% of GDP)	80.4	80.8(Jul-Mar)	83.3
Exports fob (\$ billion)	25.5	19.7(Jul-Apr)	24.8
Imports fob (\$ billion)	48.3	36.1(Jul-Apr)	45.8
Remittances (\$billion)	22.6	20.7(Jul-May)	20.5
Current Account Deficit (% of GDP)	2.2	1.1(Jul-Mar)	2.4
Gross reserves (\$ billion)	12.6	16.9(Jul-May)	15.0
Gross reserves (Months of Imports)	2.5	2.7	3.3

Source: IMF Country Report No. 20/114 and Economic Survey of Pakistan. CPI= Consumer Price Index; fob= Free on board; B.E=budget estimate

treasury bills. Finally, the cross-border channel indicates that supply-side shocks in other countries could impact Pakistani manufacturers in supply chains; border closures will result in

Traditionally, during past economic crises,

⁴ For example, to see how Pakistan's economy was affected during global financial crisis, see: Vaqar Ahmed & Cathal O' Donoghue, 2010. "Case Study: Global economic crisis and poverty in Pakistan," International Journal of Microsimulation, International Microsimulation Association, vol. 3(1), pages 127-129.

governments' own development budgets used to expand to stimulate the economy. However, there are limits to this response as timeline for reversal of COVID-19 spread is unknown.

As government cuts back on its capital investment and spends to cover for healthcare and social safety nets, the public sector's investment to GDP ratio is also expected to decline from a pre-COVID-19 level of 3.3% to 2.3%. This also points towards a very tight fiscal space to sustain current levels of stimulus over the next fiscal year.

This will indeed slow down the recovery process.⁵

There will be difficulties in fiscal management. In the short run, Pakistan will not be able to comply with the IMF's requirement of 0.8% of primary budget deficit and this will expand to 2.9 per cent during FY20. It is, however, less clear how the government plans to bring primary deficit to 0.4 per cent in FY21. This is difficult as Federal Board of Revenue (FBR) missed the July-February revenue collection target by PKR 484 billion. Besides, the government's spending needs to finance health care and economic recovery are expected to remain high.

To finance its running and expected expenditures, the government will rely on support from multilateral bodies and bilateral assistance. The central bank's projections indicate that Pakistan's external financing needs during FY20 will increase by another \$1.9

billion. To cater for these needs, Pakistan's Pandemic Preparedness and Response Plan (PPPR) has been prepared. The multilateral and bilateral partners will provide \$4.4 billion over the next 15 months to finance this plan.⁶ The IMF has already provided \$1.38 billion Rapid Finance Instrument Facility. While the World Bank Group (WBG) is preparing its comprehensive lending arrangement for Pakistan, an initial support of \$240 million has already been provided. Over the next 15 months, WBG will also provide \$2 billion in new financing while \$1 billion from already approved funds will be repurposed. The Asian Development Bank will also provide \$500 million worth Counter Cyclical Support Facility and \$305 million as Emergency Assistance Lending (EAL) within FY20.

Risks to current account have reduced after external assistance. However, there are limits to such assistance from abroad. Ultimately, the government will have to bridge the growing financing gap through non-debt inflows. Unfortunately, the Overseas Pakistani Foundation is expecting a return of significant number of Pakistani workers from abroad, particularly in gulf countries.⁷ This is expected to hurt remittance inflows by at least a quarter. We also understand that weakening of financial markets could translate in to a potential financial contagion for many countries which are trading partners of Pakistan. This in turn can keep demand for Pakistan's exports subdued during FY21. Exports have already decreased

⁵ See linkages between public investment and economic growth here: Ahmed V., Abbas A., Ahmed S. (2013) Public Infrastructure and Economic Growth in Pakistan: A Dynamic CGE-Microsimulation Analysis. In: Cockburn J., Dissou Y., Duclos JY., Tiberti L. (eds) Infrastructure and Economic Growth in Asia. Economic Studies in Inequality, Social Exclusion and Well-Being. Springer.

⁶ "Creditors pledge Rs708b for Pakistan to fight Covid-19." The News. April 28, 2020.

⁷ To see how this could impact at household level, see: Ahmed, Vaqar and Sugiyarto, Guntur and Jha, Shikha, Remittances and Household Welfare: A Case Study of Pakistan (February 2010). Asian Development Bank Economics Working Paper Series No. 194.

by 47.2% in the month of April widening the trade deficit to 41.8% during this month.

B. Reimagining national planning and budgeting

In the coming days, government will need to continue supporting expansion of Ehsaas – social safety nets programme across the country. Only time will inform if the PKR 1.2 trillion relief package will be adequate to mitigate the pains of the poorest. Nearly 24 per cent of Pakistan’s 210 million population was below the poverty line and COVID-19 is expected to push another 15 million in to poverty.⁸ Until now 7.3 million beneficiaries have received cash support of PKR 12,000. This number could increase in case of a prolonged lockdown and layoffs by private sector. Additional assistance will soon be targeted towards 4.3 million women beneficiaries.⁹ A PKR 75 billion packages has also been targeted towards labourers and daily wage workers. This will target around 6 million beneficiaries.

The government’s response will need to address social exclusion. At the time of writing this text, there are delays related to outreach and messaging to explain to the poor how to access relief package, biometric verification of beneficiaries, targeting in the informal sector and far-flung areas.

The recovery of small businesses will require support over medium to long-term. Central bank has cut the policy rate, expanded refinance schemes, and introduced temporary regulatory measures to help financial system’s soundness. PKR 50 million collateral-free loans

are now available for micro and small businesses. Refinancing facility is also available for firms which do not lay off workers. The government promises to cover three-month electricity bills for 3.5 million Small and Medium Enterprises (SMEs). However, it is important to mention that most of the initiatives explained above are still being rolled out. Regarding support to SMEs, commercial banks have been reluctant to quickly process loans, anticipating a slower recovery and high risk.

One-off measures may not be adequate to revive employment prospects in private sector. In our view, the forthcoming budget for FY21, expected in June, could help firms in reducing their cost of doing business. This could start by reducing the burden of tax compliance costs, harmonizing the general sales tax (GST) across provinces, and ensuring a more certain tariff structure for electricity and gas.¹⁰

The government is expected to support select industries and services to repurpose or scale up in the face of pandemic. Hospitals operating at small and medium scale are primary candidates for cut in GST on services and even rationalization in direct tax rates. Firms producing personal protective equipment could see a relief in taxes. The trade taxes faced by such producers or even hospitals importing from abroad may be rationalized. In the interest of ensuring food security, the agro and food processing enterprises may receive similar support. Several online essential services are now important for the social and mental

⁸ “Revisiting economic impact of coronavirus.” Business Recorder. April 14, 2020.

⁹ “Pakistan’s cash programme instrumental in mitigating COVID-19 impact: WB.” Pakistan Today. May 5, 2020.

¹⁰ For details regarding these suggestions, see: Ahmed, Vaqar; Talpur, Mustafa. 2016. Corporate Tax Reforms in Pakistan. Sustainable Development Policy Institute. <http://hdl.handle.net/11540/9306>. Also see: Ahmed, Vaqar; Talpur, Mustafa. 2015. Towards a Fair and Just Fiscal Policy in Pakistan. Policy Review, July 2015. Sustainable Development Policy Institute.

wellbeing of society. It is likely that the government may leverage e-commerce in the battle against COVID-19. In this regard, e-commerce policy (already approved) could see priority implementation.

C. Opportunities in COVID-19

The fall in global crude oil prices presents an opportunity to hedge the uncertainty by locking in low oil prices¹¹. Inflation has started slowing down and this is likely to take away some pressures on the demand side and help augment purchasing power. The IMF has also announced that it will shield Pakistan's economy from any unanticipated balance of payment problems.¹² It is expected that Pakistan may request for some relaxation in the time allowed to implement the structural reforms.¹³

The volatilities related to current account have stabilized on the back of low import demand and falling oil prices. Going forward, it is important that opportunities presented by COVID-19 for exporters may be harnessed. Textile and garment exporters could repurpose production items and supply the necessary safety wear for doctors and paramedics. The demand for surgical goods and pharmaceuticals may also increase. The recent Pak rupee depreciation could make exports even more competitive. Likewise, automobile

and auto-parts sector is expected to repurpose in favour of producing ventilators and related accessories.

COVID-19 has also mitigated the immediate political threats to the PTI government. The government has an opportunity to improve health sector service delivery to prove its governance. The regional integration process has once again been initiated with South Asian Association for Regional Cooperation (SAARC) emergency fund being operationalized.¹⁴ Many believe that this could prove to break the ice between India and Pakistan. Afghanistan and Pakistan have also come closer with the latter having opened borders to transport transit goods five times per week. Opening up trade in health services with neighbours is also an immediate opportunity.¹⁵

COVID-19 provides an opportunity to the government to put in place measures, which could reduce digital inequality and help 'freelance' and e-commerce sector. With social distancing measures in place, people will find tremendous value in paying bills online, making online funds transfer, and order essential items online. This behaviour may not lead to an exponential increase in usage of digital tools, but it can certainly make more people aware of and reliant on the conveniences afforded by digital economy¹⁶.

¹¹ "Oil: To hedge or not" - Business Recorder Research (March 11, 2020)
<https://www.brecorder.com/2020/03/11/579028/oil-to-hedge-or-not/>

¹² "Statement by IMF Managing Director Kristalina Georgieva on Pakistan." IMF Press Release no. 20/113.

¹³ "IMF allows exclusion of corona prevention expenses' from fiscal deficit" - The Nation (March 7, 2020)
<https://nation.com.pk/17-Mar-2020/imf-allows-exclusion-of-corona-prevention-expenses-from-fiscal-deficit>

¹⁴ "PM Modi proposes emergency covid-19 fund for SAARC nations" - Economic Times (March 16, 2020)
<https://economictimes.indiatimes.com/news/politics-and-nation/prepare-put-dont-panic-is-indias-mantra-to-counter-coronavirus-narendra-modi/articleshow/74638006.cms>

¹⁵ Some suggestions on these lines are provided in: Mazoor, R., S. K. Toru, V. Ahmed (2017) Health Services Trade between India and Pakistan. The Pakistan Journal of Social Issues, Volume VIII (2017).

¹⁶ "Corona and Pakistan's on-demand economy" - Business Recorder Research (March 19, 2020)

Greater use of online banking channels to complete transactions has also improved resilience of the financial sector in Pakistan.

D. How COVID-19 could impact ongoing reform?

COVID-19 will impact Pakistan's progress towards the IMF programme in three ways. First, the schedule of regular review and monitoring of the macroeconomic performance will alter. It is likely that the reviews may take place after slightly longer intervals.¹⁷ Second, as central bank is expected to pursue quantitative easing¹⁸, therefore some performance criterion and indicative targets could slightly change to accommodate monetary and fiscal expansion. The criteria¹⁹ which could see some flexibility during FY20 include ceiling on net domestic assets, net foreign currency swaps, primary budget deficit, budgetary borrowing from the central bank. In our view, IMF will not be flexible to allow ease in the ceiling on amount of government guarantees. This could also slow down the projects planned under the second phase of China-Pakistan Economic Corridor.

Likewise, some relaxation in indicative targets is possible. This could include ease in floor on social sector spending (possible diversion of resources to health sector), and floor on net tax revenues by FBR (lower collection expected due to negative GDP growth rate). In our view, there may not be flexibility to alter ceiling on

power sector payments arrears, due to fall in oil prices. IMF would like to see the government continue on the path of power sector reform and address the circular debt issue.

Furthermore, to help the exporters it is likely that FBR will expediently process the refund payments.

There may be some alterations to the structural benchmarks²⁰ depending upon the severity of COVID-19. First, the government had committed not to granting tax amenities during the program period. We have however seen that to revive aggregate demand, the federal government had to announce a construction sector package, which includes a tax amnesty component. Second, due to the heightened pressures on the federal cabinet, and inability of parliament to meet physically, there have also been some delays in the amendments to the State Bank of Pakistan Act. Third, in connection with reforms of loss-making state-owned enterprises, there is a possibility that privatization program may be expedited, in case the government faces issues with regard to financing of budget deficit. Fourth, the government has already sought four months relaxation to comply with the remaining actions desired by FATF. It is likely that a further extension may be allowed on sympathetic grounds, however there will be increased monitoring of measures to counter illicit financing during COVID-19 times.²¹ Finally, while IMF has directed the government to avoid the practice of issuing new tax exemptions, it is likely that sectors such as health services, and producers of personal protective equipment may receive a tax relief,

<https://www.brecorder.com/2020/03/19/581478/corona-and-pakistans-on-demand-economy/>

¹⁷ In the past, these reviews were supposed to take place every quarter.

¹⁸ Practice of purchasing government securities to inject capital into the economy.

¹⁹ A complete list of performance criteria available in Table 11 of IMF Country Report No. 19/380.

²⁰ A complete list of structural benchmarks available in Table 12 of IMF Country Report No. 19/380.

²¹ "Welcome moratorium by FATF." The Nation. April 10, 2020.

including rationalization of customs duties for inputs.

Pakistan remains committed to the reforms agreed under the EFF. The IMF authorities will however resume discussions on the next review of EFF once COVID-related pressures ease.²² For the time being, a key priority for IMF will be to keep Pakistan's public debt within sustainable limits. The April 2020 IMF country report does inform that the pandemic could be a risk to debt sustainability, however debt levels can be brought downwards in latter half of FY20 through help from bilateral creditors, including China, Saudi Arabia, and UAE.

The government has also formally approached G-20 countries for debt relief. If successful, the country's \$ 1.8 billion repayment due by December 2020 will be deferred. This

repayment is owed to eleven G-20 economies (including Japan). Pakistan will have four years to repay this sum, but will have to provide a commitment to not procure any new non-concessional loans until the previous debt servicing is completed.²³ Such a development will help in keeping debt-to-GDP ratio within limits. It is expected that this ratio will hover around 90 by end of FY20. However, the government is also advised to make arrangements to boost non-debt inflows to cover for expected external financing gap of \$1.5 billion in FY21.

²² "IMF representative terms performance of Pakistan's economy satisfactory," The News. April 21, 2020.

²³ Pakistan can still access those non-concessional loans which are allowed under the IMF Debt Limit Policy.

Budget 2020-21

Pakistan needs a new fiscal policy

Dr Sajid Amin Javed

Month of June in Pakistan is widely known for hot summers as well as federal and provincial budgets. Following the pandemic, the federal budget 2020-21 is very critical. Critics view this budget document from three dimensions: whether it protects the people from socioeconomic fall-out of the pandemic, has the ability to mitigate the adverse effects of the pandemic, and supports economic recovery in these testing times. The advice is simple;

- Don't fear deficits and prioritize people over economy;
- Focus on social spending to protect people now; and
- Get ready for borrowing to fill the deficits.

The federal budget 2020-21 does not seem very promising from the perspective of ability to mitigate the socioeconomic impact of the pandemic and drive the economic recovery. It may be a good budget, as it does not impose new taxes. On the contrary, it is a status-quo budget, as it does not provide any relief to pandemic hit masses, workers and small businesses.

Good that no new taxes, if budget speech is any guidance. This is, however, sufficient to ensure that it is not a pandemic budget. Maintaining the tax lines and rates designed on a higher side to meet the IMF targets aiming at stabilization of economy do not qualify "expansionary fiscal policy" as the budget speech claimed. Tough for normal times, as the

last year performance on revenues exhibited, these rates cannot stimulate economic activity because they are not designed for it.

The budget has amplified the already rampant uncertainty on roadmap for economic recovery. Take example of the revenue target of Rs 6,573 billion for FY2021. This is around Rs.1000 billion higher than last year's target which we missed.

A budget claiming no new taxes aims to collect Rs 1 trillion additional in a crisis year than a normal year cannot be realistic. This is mainly guided by yet another unrealistic GDP growth target of 2.1% which in itself is based on some weak assumptions that economy will sprint on recovery after we have opened the lockdown. Remember, this will be done under tax structure, which led to 1.9% growth rate in a normal year 2018-19.

The budget limits to an accounting exercise when one looks at the revenue targets of Rs 4,963 billion for FBR and the economic landscape of the country. FBR was able to collect around Rs3,063 billion during July2019-March2020 before the outbreak of the pandemic against the revised target of Rs3,521 billion - a shortfall of Rs458 billion. If we generously agree on the same collection during July 2019-March 2020, the board has to collect Rs 1,900 billion extra in the last quarter. Since it is an economy, which has yet to see the toll of the pandemic.

Economic landscape does not support these numbers. Induced by last years is 15.7% growth in sales tax, government proposes to collect Rs 2.9 trillion through indirect taxes. Sales tax contributed 38.1% to total tax revenues in FY2019-20. This, however, was because of inflation tax mainly. People have to pay higher tax in rupees for the same quantity of purchase when prices are higher. The revenues from this head in FY2021 will drop with the inflation slowing, already from more than 14pc to 8.22pc in May 2020.

Non-tax revenue in the outgoing fiscal year mainly came from SBP profits. It will face a significant decline after 525 base point cut in policy rate over the last three months, with further cut in policy rate months ahead. Add to it the announced cut in Federal Excise Duty (FED) and locust impact on agriculture. It is in this context that budget seizes to the be roadmap for economic recovery. To the best, it is a signaling for the Fund that we comply the Extended Fund Facility (EFF).

If one needs more evidence that it is not a pandemic or growth budget, one must look at the deficit target for FY2021. The government has set the deficit target for crisis year, which is lower than a three-quarter normal year (July 2019 -March 2020). The last year deficit, with only last quarter in COVID crisis, reached to around 9%. A rational budgeting cannot calculate any deficit below this number when expenditures in the form of expansionary fiscal policy are more than ever required, i.e. when revenues are likely to fall below the normal year collections and when economic activity is likely to remain slower.

Unrealistic revenue target is behind this anomaly which itself begets from blaming the crisis to eat up revenue collection of Rs 900

billion in the last quarter of the FY20. This added to uncertainty and seeds the poor economic policy for the year. One way or the other, deficit will touch 9% or higher in this year. Aiming 9% deficit in budget would have allowed not only created space to increase government expenditures but also reduced the likelihood of mini budgets or quarterly revisions. It is time to run for deficit.

The government seems to have gone all-out to restrict the overall budget deficit around 7% and primary deficit to 0.4% of GDP, the desired limits of the IMF programme. Though it would have been good in normal times, it is not in crisis. To control deficits, the government seems to have been holding the spending hand. Despite the scale of pandemic and its socioeconomic fallout, the budgeted expenditures for 2020-21 of Rs 7.13 trillion, is slightly higher than 6.83 trillion, the revised expenditures for 2019-20.

Without any doubt, the government faced a unique challenge- (that a peer country in the region do not) that it has to keep its commitments of fiscal and budget deficit with the Fund while preparing budget. However, the fund is likely to have ignored deficits arising from social spending, including social protection, health and other incentives, to support Small and Medium Enterprises (SMEs) and micro businesses. The budget did not do good at this front.

Take example of health sector. Only Rs 20 billion has been allocated to the sector which is not only most severely hit by the pandemic but also will be shaping the socioeconomic fall-out of the pandemic. Failing to protect the public health is likely to significantly affect the economy through productivity loss,

absenteeism, reluctant consumers, fiscal and other costs associated with COVID-19.

Same holds true for social protection.

Budgetary allocation for Ehsaas programme is Rs 208 billion in 2020-21 compared to Rs 187 billion last year. Given the size, magnitude and vulnerability of non-poor to the pandemic, this is less than required. The resources saved from freezing the pensions and salaries should have been converted into social protection.

Federal PSDP, when required to be increased, faced 18% cut compared to FY2019-20 and stood at Rs 650 billion. One may find explanation that it is a provincial subject and provinces will have larger PSDPs. This however may not be true as provinces will also be facing cut in resources. The government has to accept that given the limited revenues collected last year, almost Rs 900 billion, the provinces will face a cut. A higher provincial PSDP is only possible if the federal government can borrow on behalf of provinces.

It also fails on facilitating the economic recovery and Pakistan is likely to continue to weak economic growth in FY21. GDP growth rate target of 2.3% seems over ambitious. Agriculture recorded growth of 2.64% is likely to drop in FY21. Similar, industry and services will struggle due to disrupted value chains and global economic meltdown. The government, by all odds, is likely to miss the target.

Overall, the federal budget still is a budget that may lead to stabilization, but it lacks the characteristics of a growth-oriented budget. While it does not impose new taxes, it does not provide the required incentives in these troubling times. Crippling state of affairs on controlling the coronavirus situation- thanks to confusion prevailing at the highest offices -

suggests poor economic landscape. Failing to manage locust, already visible-would make the situation worst. Exports during July-April, 2019-20 remained \$ 19.7 billion compared to \$ 20.1 billion during July-March, 2018-19, posting a decline of 2.4 per cent.

Debt repayments remain major consumer of resources with Rs 3.235 trillion (\$19.90 billion) that was earmarked for debt servicing. Clearing liabilities of debt servicing leaves literally zero resources with the federal government that has to make some arrangements to adjust debt repayments to create space for necessary expenditures. External debt servicing can be rescheduled. Similarly, tax collection needs to be seriously improved if Pakistan has to maintain a minimum threshold of spending required to mitigate the effects of pandemic and to ensure economic recovery.

The budget seems missing the single most purpose of protecting people and reviving the businesses in the face of unprecedented economic crisis. Good on accounting, it may have been appropriate for a normal year. But, the scale of the crisis, poor landscape of the economy pushing millions unemployed and below poverty, would have required easing the taxes - originally designed for economic stabilization under EFF- and providing a breathing space.

Claiming to be expansionary in stimulus, this is mainly a budget limited to controlling the deficits. It offers nothing to mitigate socioeconomic fallout of pandemic and fails to provide roadmap for the much-needed economic recovery.

A post-budget review of Pakistan's power sector

Ahad Nazir

The budget 2020-21 has allocated PKR 74.5 billion for the energy sector. This budget reflects the vision of the government displayed as the alternative and renewable energy policy and focuses mainly on enhancing the transmission and distribution capacity along with introducing green energy initiatives in Pakistan. The challenges reported in the latest economic survey of Pakistan include the variable and seasonal demand supply gap and the optimization of the energy mix (Ministry of Finance 2020).

The subsidies kept for the power sector are budgeted at around PKR 149 billion. These subsidies along with other factors give rise to the main bottleneck for the power sector, i.e. the circular debt which has soared to PKR 1,200 billion.

One of the major factors contributing to the circular debt is the contract types and tariff structures of current Independent Power Producers (IPPs) which is being resolved through bringing in national competitive bidding tariff type in the case of future IPPs. Keeping this scenario in view, there is a need to take medium to long-term measures for an improvement in the energy sector of Pakistan.

Economic activities, growth, and development in any country, area or region depend upon the uninterrupted supply of energy to all the sectors of economic ecosystem. Lack of policy-level focus in Pakistan in this regard has caused several issues. Pakistan remained faced with

energy crisis from 2007 to 2014, which resulted in huge economic losses of around 7% of the GDP (Pasha et al. 2013) in addition to the accumulation of circular debt of around PKR 450 billion, which was paid off by the former government in 2014. However, the debt has again surged to PKR 1,200 billion¹. With an investment of around PKR 1.8 trillion since 2013 in the energy sector of Pakistan², continued supply of electricity was ensured, but unfortunately, it led to an increase in the consumer-end cost of energy. This high cost ultimately impacted the competitiveness for the private sector in general and export sector in particular. (Ahmed 2018). An increased manufacturing cost of goods has also affected the other modes of the supply chain, including Small and Medium Enterprises (SMEs), traders, wholesale markets, retailers, and the end user.

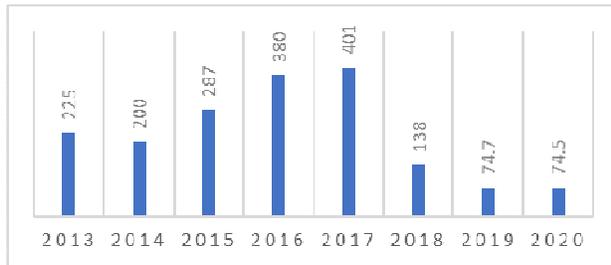
Figure 1 shows the allocations budgeted by the government from 2013 to 2020. An analysis of the electric power supply chain shows that the major chunk of these allocations was made in power generation sector and less emphasis was placed on transmission and distribution. Although transmission and distribution losses have not been detailed in the current and previous year economic surveys, they have a

¹ Budget speech by Finance Minister. Hammad Azhar in the National Assembly on 12th June 2020, an available at http://finance.gov.pk/budget/budget_speech_english_2020_21.pdf

² This figure was calculated based on analysis of budget documents on www.finance.gov.pk

huge impact on the economy of the country. According to estimates, these losses account for more than 7% of the GDP.

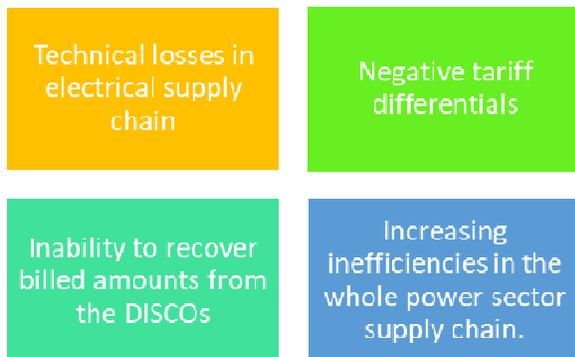
Figure 1: Allocations for Energy Sector (PKR in billion) from 2013 to 2018



Source: Ministry of Finance

The circular debt is now surging, and it is the single symptom of many problems faced by the power sector of Pakistan. The main causes identified for this circular debt are presented in Figure 2 (Asian Development Bank 2018).

Figure 2: Causes of Circular Debt

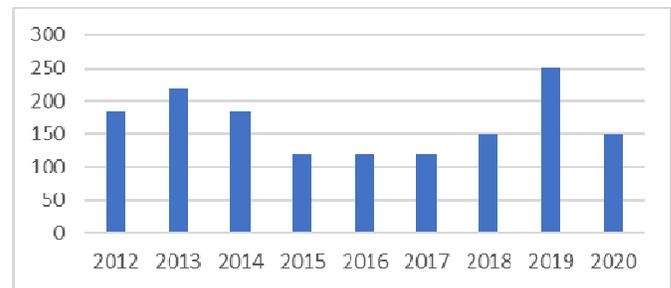


Though transmission and distribution losses have decreased due to actions taken by the distribution companies by increasing recoveries, reducing theft and enhancing substation technologies (National Electric Power Regulatory Authority 2019), a lot of improvement is required to increase dependence on alternate and renewable energy fuels and phasing out of fossil fuel-based power plants, which may bring about a change in the supply side load centres in the

next few years. Several of the power purchase agreements with independent power producers are also concluding this year.

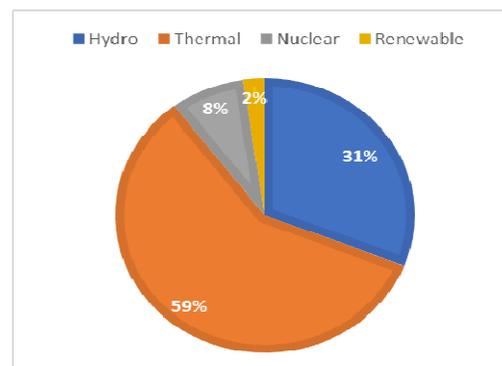
Every government tried to reduce the subsidies provided to power sector. These subsidy amounts (displayed in Figure 3) are usually overrun by around 35% on average each year. This year's revised estimates for subsidies have not been provided in the budget.

Figure 3: Budgeted subsidy to power sector in PKR (in billions)



Furthermore, the reliance on imported fossil fuel-based power plants is also one of the major factors affecting Pakistan's power sector. The current energy generation mix is provided in Figure 4. This depicts a major share being contributed towards fossil fuels.

Figure 4: Generation Mix (April 2020)



In addition to the continuation of efforts being made by various government organizations, following are the major policy

recommendations to address the issues facing the energy sector in Pakistan.

On the generation side, the new renewable energy policy of Pakistan describes the government vision to reduce reliance on imported fossil fuels (30%) and increase the energy mix weightage of hydro (30%) and renewable energy (40%) generation in Pakistan by 2030. The government should focus on bringing Gilgit-Baltistan in the national grid and focus on run of the mill medium to large hydro projects. At present, the hydro potential is going waste because most of the investment being put in is on sub-tributaries of Indus river, which is cost inefficient. This will also ensure less power loss during winters. Furthermore, the detailed survey of Pakistan coastal belt, and surrounding areas for wind energy potential needs to be carried out for onshore as well as offshore wind farms. The government needs to lure in investment by ensuring security in these areas. The tariff determination for all future IPPs should be based on national competitive bidding process. This will not only ensure development of local expertise and product in the sector but also ensure that with availability the cost of energy is also kept low and will in turn increase the competitiveness of the export sector of Pakistan.

Secondly, the renewable energy policy implementation becomes an uphill task, since this will require an overhaul of the complete energy supply chain infrastructure. The major challenges will include the shifting of supply side load centres to new ones. This will require significant investment and focus on transmission sector of Pakistan. This will require expedition of the running transmission and distribution projects including the 660kV HVDC transmission line which will stretch from Matiari,

Sindh to Nankana Sahib, Punjab. Furthermore, reciprocating work on transmission is required on each generation load centre; for example focus is required on the wind corridor in Thatha with the inclusion of new grid stations.

Thirdly, the distribution companies may be unbundled, especially for Balochistan because economic development due to China-Pakistan Economic Corridor (CPEC) will increase the power generation and consumption of the province. The unbundling will ensure better recoveries and lower theft. The introduction of pre-paid electricity meters used in community based micro hydro power plants in Hunza, Gilgit-Baltistan can also be replicated for such areas. The distribution companies may continue gradually improving their distribution infrastructure using modern state of the art technologies which may ensure lower losses and outages.

By focusing on all modes of the energy system supply chain, the government might be able to provide access to sufficient and cheap electricity in order to ensure that all sectors of the country will move towards economic development and growth.

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Rethinking economic paradigm after COVID-19

Dr Vaqar Ahmed

This is perhaps the first time in Pakistan's history when people from all strata of society fully understand that the estimates of the federal budget 2020-21 are mere indicative of figures and bound to be revised sooner or later. A budget where interest payments, defense spending, and civil administration expenditures are on the rise paints a sorry state. On the contrary, a budget in which job creation, infrastructure and social development are badly ignored cannot be a pro-poor or even pro-masses budget.

Major slippages are expected as against the projections by Ministry of Finance. First, the low economic expansion envisaged during the next year will ensure that FBR's tax targets are not met. Besides, the budget brings with it exemptions and tax relief for several conventional revenue spinners. Second, as the COVID-19 timeline goes well into the first and second quarter of the next fiscal year, the government needs to win favour by taking a U-turn on federal subsidies – currently projected to decline by 40%. It is unlikely that power sector subsidies could be done away with if the government aims to opt for 'smart' and

'selective' lockdown strategy. Such subsidies may well be provided to mitigate pain and win political favour of the private sector.

Third, alongside COVID, Pakistan's economy is also confronted with locust attack which has threatened the livelihoods of farm sector. Now, it is difficult to believe as if the government

could actually reduce relief to agriculture by almost 75% as envisaged in the budget. The food subsidies and support to Utility Stores Corporation has also been slashed by 54% and 93% respectively, which will be a very hard act to follow once any food price inflation or shortages set in.

Fourth, the state has also realized that it may not be able to bear the burden of loss-making public sector enterprises for long, hence we see the move to fire workers of Pakistan Steel Mills. The Government of Sindh has vowed that it will prevent federal government to actually implement this decision as this was never discussed during any meeting of the Council of Common Interests. In case, this attempt of Islamabad is foiled and FY21 also carries the losses of public sector enterprises and state-owned units, it is hardly possible to achieve a 23% reduction in federal grants as projected in the budget.

COVID-19, locusts attack, energy sector losses, hemorrhaging in public sector enterprises, rising domestic and external debt, and an unrealistic expectation that provincial budgets will provide surpluses are the factors that point towards a near collapse of the conventional macroeconomic framework.

What are the government choices in FY21? To avoid a large shortfall in tax revenues the government needs to move its focus from squeezing the existing taxpayers towards introducing reforms in tax administration and

audit, which could help all tax bodies across the country to correctly identify and reach the large non-compliant taxpayers. Better federal and provincial coordination is need of the hour to unearth instances of evasion and avoidance.

With the shrinking size of the development budget, a more coordinated planning and execution of Public Sector Development Programme (PSDP) and provincial Annual Development Programmes (ADPs) is desired. The federal and provincial finance secretaries now have a working committee that meets regularly to coordinate financial releases. This model is now required by the Planning Commission, and provincial Planning & Development Departments. This could prevent duplication of development schemes across the provinces and bring overall efficiency in spending and monitoring of projects.

To kickstart the process of economic growth, it may be difficult for businesses to attract large investment. The government can however help reduce costs, particularly for micro and small enterprises. This may be by done by rationalizing the regulatory costs faced at the federal, provincial, and local tiers. Pakistan Regulatory Modernization Initiative (PRMI) needs to expedite its efforts to conduct a regulatory impact assessment – based on which regulatory burden may be reduced.

The World Bank Group expects the global economy to contract by over 5 per cent this year. Such a situation makes it very difficult for the government to expect a rise in non-debt inflows. It is in this context that out-of-box measures are required to help boost exports and remittances. For the former, it is now essential that the government executes measures approved under the Strategic Trade Policy Framework on a war-footing. This will

help the exporters to pivot and repurpose in the face of Covid-19.

Finally, COVID-19 will give rise to ‘big government’, expansion in public administration services and expenditures. Growing expenses are bound to test government’s commitments under IMF’s Extended Fund Facility and Public Finance Management Act 2019. The ceilings on borrowing may also be breached. It is in this context that a business-as-usual debt management strategy will not work. The Ministry of Finance along with provincial finance departments needs to chalk out a very different approach to mitigate any possible default.

(- Courtesy *Arab News* dated June 15, 2020.)