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Asad Umer's Round Two

Finance Minister Asad Umer has been consistently right when he accuses the previous administration of leaving behind an economy in shambles but been consistently wrong in claiming success through giving the right direction to the economy both in the first and the second supplementary finance bills 2019.

The legacy of the five years of the Sharif/Abbasi administration was a historically high current account deficit with declining exports and rising imports, an unsustainable budget deficit, declining industrial output, the sector that traditionally supported the Sharif administration, and declining farm output - all attributed to the flawed polices of Ishaq Dar. These flawed policies ranged from heavy reliance on concessional external borrowing (possible during the time that the country was on an International Monetary Fund programme from September 2013 to September 2016) and thereafter on borrowing bilaterally/commercially/issuing Eurobonds/Sukuk at very high market rates, supplemented with massive domestic borrowing. Dar's attempt to keep the rupee stable through external borrowing and market intervention and his entire focus on reducing the budget deficit (he was also not averse to data manipulation), compromised the country's growth rate. Additionally, Dar's fiscal policy, like his predecessors', was to tax the already taxed and rely on raising tariffs (electricity and gas) to improve the balance sheet of these sectors rather than focus on improving governance.

Electricity and gas tariffs have already been raised once during the five months of the Pakistan Tehrik-i-Insaaf (PTI) government with governance not yet improved as circular debt continues to rise, reliance to the tune of over 15 billion dollars on concessional borrowing from friendly countries payable within one year (though the window of a possible deferral remains open), and domestic borrowing in the first six months of the current year rising to a whopping 3 trillion rupees. The poor and vulnerable continue to receive subsidies/cash grants that were also extended during the previous two administrations (in electricity tariffs, Benazir Income Support Programme etc.) and the PTI government's major policy thrust to provide employment and disseminate wealth to the poor is to be: (i) through providing incentives to the rich industrialists hoping the trickle-down theory would take care of the poor and the youth, a policy reminiscent of the Sharif era, and (ii) to build houses for the poor which would fuel the construction sector for which qarze husna (interest-free loans) would be provided though the criteria of selecting the limited number of beneficiaries of the scheme remains unclear.

The question is what has Umer done in the two supplementary finance bills that may indicate a direction, an out of the box thinking that may provide a comfort level to economists and the people of this country? Or perhaps a more appropriate question would be what has he not done to resolve the crisis that he inherited? Asad Umer has so far not dealt with the budget deficit which may lead many an economist to speculate that his strategy is not markedly different from what was in force during the previous administration(s). Instead the Khan administration acquired loans from friendly countries at less than market rates from Saudi Arabia and the UAE (details of loans' being negotiated with China have not been released) but what must be acknowledged is that these are loans not grants in foreign currency which must be repaid.

No new taxes in his second finance bill Umer loudly and proudly proclaims however the finance bill 2 envisages a reduction in revenue to the tune of 6.8 billion rupees - a 10.8 billion rupees industrial incentive package to be partly met by enhanced taxes mostly on luxury cars and from non-filers now allowed to procure cars estimated at 4.39 billion rupees. With only 5000 rupees additional tax on non-filers purchasing 1300 cars it is doubtful if that would tempt any non-filer to begin filing his/her returns. The National Taxation Reform Commission report is available and provides detailed recommendations to transform the existing unfair and anomalous tax system into one that would be equitable and non-anomalous.

Annual injections in excess of 1.5 trillion rupees per annum required by autonomous monolithic white elephants including Pakistan International Airlines, Pakistan Steel Mills, and Pakistan Railways has, five months into the Khan administration, not led to the implementation of any remedial measures. Sadly, the approach of the incumbent government to resolve this annual drain evokes images of the PML-N administration's approach in that the PTI maintains that unlike previous administrations it will select/appoint on merit. The recent selections/appointments including those of cabinet members and bureaucrats unfortunately leave little room for complacency. A much better approach would have been to establish a system where selections/appointments are made entirely on merit by a three member selection panel of individuals of integrity, as recommended by the Supreme Court.

Umer reduced development outlay in the first finance bill to reduce the deficit, a usual approach in this country spanning several administrations. Given that in Pakistan it has been the government that spearheads investment, this reduction invariably leads to a decline in the growth rate and this is reflected by multilaterals downgrading our growth rate in recent months. To add insult to injury in his second supplementary finance bill Umer has given incentives to industry (that explains why it is being volubly supported by industry and traders) with the government relying heavily on the trickle-down theory to spread wealth to the new entrants in the labour market and the poor. Notwithstanding the overwhelming research that challenges the effectiveness of the trickle-down theory neither the first nor the second finance bill focuses on reducing current expenditure. Given the exemplary civil military relations today one would have hoped that he had negotiated lower annual outlay with the civilian and military establishment for after all sacrifices are required to be made by all sectors and not just the general public.

The Khan administration without a doubt is relying heavily on two major funding sources to deal with the revenue crisis. First and foremost is its commitment to bring illegal wealth back into the country and for this purpose the supplementary finance bill 2 seeks to provisionally estimate and tax offshore assets held by resident Pakistanis and in the event of non-payment to appropriate local asset to recover the tax due. One would not be remiss in assuming that this particular legislation would not only impact on the fortunes of the Sharifs and the Zaradris and their second tier leadership but also many coalition partners of PTI as well as PTI members themselves and therefore the demand to water down this particular legislation may come from both sides of the aisle.

Secondly, the administration is relying on investment from friendly countries (Saudi Arabia, the UAE and China) as well as on getting oil at deferred payment which is a one year deferment. Imran Khan is relying heavily on these friendly countries delivering on their promise to invest in Pakistan but one would urge the government to negotiate the terms of the deal transparently and table them for parliamentary approval. The reason is compelling as previous multibillion dollar deals were reneged on by subsequent administrations and Pakistan has lost cases in the international court and is due to pay penalties of billions of dollars for example in the case of Rekodiq, Karkey rental power project, etc.

The economic vision of the government, Umer stated, will be presented in the Medium Term Budgetary Framework (MTBF) which is prepared jointly by the Ministry of Finance (which sets expenditure limits of line ministries) and Ministry of Planning Development and Reforms which sets the development agenda of the line ministries. Given the state of the finances it is unlikely that the development agenda would be ambitious besides it bears recalling that the MTBF of previous administrations were economically very sound however they were never implemented.

"We will not be dictated to," is as persistent a cry of Asad Umer as is the claim that the Khan administration is focused on the poor and the vulnerable. If the IMF is the route that the government will go, as stated by Umer during his speech, then dictation is not only implicit but would also be explicit while the trickle-down theory makes many an economist suspect that the focus on the poor and vulnerable is almost certainly going to get sidetracked in the medium-term defined as two to three years at a minimum.

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