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Budget 2019-20: price to pay for a brighter future?

Some find the budget 2019/20 harsh; others expected a tougher one. Some see in it a sinister foreign hand; others the inevitability of it -'home-grown solutions' would merely prolong the agony. On the whole, after all the kicking and screaming, most see it for what it is: penance for years of indulgence.

For years, and history didn't begin with the last government, we have been living off others: grants and gifts, loans and debt-forgiveness. Indeed, some leaders looked upon foreign benevolence as a matter of right - reward of a 'successful' foreign policy.

The day of reckoning had to come and it has - with a vengeance. You don't need to announce a Commission, at the stroke of midnight, to make a tryst with destiny that you made not ten but several years ago.

Destiny was written when you facilitated domestic resources to fly out while seeking others' money to flow in, giving a new meaning to 'Dutch Disease'; when amnesty after amnesty followed violation of the tax code; when businesses found 'connections' more rewarding than productivity enhancement.

Does this budget promise a brave new world? How, and to what extent, will the stabilisation that it seeks put us on the path to sustainable economic growth? How long will it take?

It is a good sign that the debate has shifted from the need of a harsh budget to probability of meeting the targets. Focus now is not on the imperative of narrowing the deficits but if the targets are too ambitious. Will the revenue target be achieved, and what happens if it is not?

Our money is on the target being met - by hook or by crook. Slippage is not an option. The alternative is scary: to protect the IMF programme, which we think we must, we may have to resort to new, mostly regressive, levies. In other words, a slew of 'mini-budgets' that will add to uncertainty that we must avoid.

What engages us more is the impact this gigantic revenue effort might have on our short term growth prospects. Equally compelling is the enquiry into how the deficit will be financed, now that recourse to SBP has been taken off the table.

On the external side, shrinkage of current account deficit is expected to continue, but the gross financing requirement will still be huge (USD 20 billion?). With exports estimated to rise to USD 26 billion only, clearly reliance is being made on further tapering of imports. What will further import containment do to our growth prospects?

Conventional wisdom puts macroeconomic stability as a necessary pre-condition to growth. You can 'buy' growth but can't sustain it with runaway fiscal and current account deficits. Further, the imbalances will be of a recurring nature unless you undertake 'structural reforms'.

It is the depth and speed of structural reforms, they say, that secures the transition from stabilization to growth; and this is where Pakistan gets off the train much before the destination.

The budget is not without some bold overtures towards reform: documentation (and doing away with the Darian legal fiction of non-filers), eliminating distortions (escape clauses?) in the tax law, reduction of subsidies that give the wrong investment signals, a tentative roll-back of Final Tax Regime, signs of progressive taxation, market-based exchange rate, tight monetary policy and disciplining the real estate sector.

There is likely to be strong ownership of the reform agenda, leading to removal of several aberrations that got perpetuated over the years. The dominant question, however, is the extent to which reforms will bring us closer to the ultimate goal of economic growth. How soon can we expect investments to perk up to promote job-creation, tax buoyancy, and exports?

To hazard an answer one has to look at the numbers Ministry of Finance has forecast for 2021/22 (using FY 20 as the base year). Budgetary deficit is pitched at 3.6% of GDP (down from 7.1%), tax revenues at 17% (up from 14.4%), and expenditure at 22.8% (down from 23.8%).

These are magical numbers indeed when seen in the context of an economy undergoing major repairs, and where all the low-hanging fruit has been harvested. How FY 20 deficit is proposed to be financed gives an idea of the challenges ahead.

Apart from an unrealistic provincial surplus (423 billion) and unimpressive privatization proceeds (150 billion) the entire deficit of 3 trillion plus is going to be debt-financed, mostly external. Unless interest rates fall sharply and rupee strengthens miraculously (both unlikely) debt servicing burden will grow further, even if some of the external debt that carries softer terms is used for budgetary support.

On the resource side there will be less to squeeze over the next two years as economic activity is likely to remain tepid - and there is little chance of SBP continuing to throw up record-breaking profits that have been programmed for the coming fiscal (406 billion). With luck, and some engineering, tax revenue may hit 14.4% of GDP in FY 20, but 17% two years from now? That would make budget 2019/20 look like a walk in the park!

Let us go berserk. Let us say by 2022we have a tax to GDP ratio of 17%and fiscal deficit down to 3.6%. Let us throw caution to the winds and hope inflation is 6%, interest rates down to this side of 10%, and the dollar steady at 155. Will all this usher in growth?

GDP growth, more so in our case, is a function of luck (good weather for agriculture, supportive global environment for exports, low oil prices) and business confidence. Yes, policy certainty helps but most invest on the basis of opportunity, not macroeconomic numbers.

With escalating costs, weakening demand, and the time-lag of reform beneficence, it will be unrealistic to expect investments to take off any time soon. It would require much more than 39 months of IMF superintendence for the gains to start accruing.

Budget 2020 should be welcomed - we didn't really have a choice - but people need to be warned it is going to be a long haul. To expect quick results would be delusional. Government's communications machine needs to get into top gear.

Without the IMF, we risked becoming another Venezuela; with it we could become Greece, and the long nights of austerity. Some choice!

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