

IMF and the budget 2020-21

Credible reports sourced to the Ministry of Finance indicate that the International Monetary Fund (IMF) is insisting on an expenditure cut in the budget for 2020-21 as a precondition for the revival of the 39-month 6 billion dollar Extended Fund Facility (EFF) programme – stalled due to the Covid-19 pandemic as a staff-level agreement on the second review was reached on 27 February 2020; however, approval of the IMF Board was deferred till April prompting speculation that pre-tranche release conditions would have to be met first. This agreement was deferred as Covid-19 began its onslaught in March.

The suggested cut in expenditure reportedly includes salaries and pensions as well as other expenditure items with the government opposing this move by pointing out that any cut may lead to protests outside the Secretariat. And not noted though certainly in the minds of members of the executive would be the political fallout of such a decision as it would strengthen the hands of the opposition. Be that as it may, two pertinent facts need to be highlighted. First and foremost, the conditions agreed between the IMF staff and the country's economic team leaders on 12 May 2019, uploaded on the IMF website, indicate that the Fund's focus was on containing the primary deficit, which excludes interest payments on debt and/or payment of principal as and when due, and not on the budget deficit (mismatch between total government expenditure and total revenue). Business Recorder consistently pointed out that this agreement was flawed because it allowed the government to borrow internally and externally without any compunction and from whatever source was available (other than to borrow from the State Bank of Pakistan), irrespective of the rising cost of this item in the budget and its fallout on the budget deficit. And to ignore the massive rise in the budgeted expenditure for the current year - 40 percent rise in development expenditure and a whopping 30 percent rise in current expenditure - was baffling as the budget deficit with its impact on inflation was ignored while contractionary fiscal and monetary policies, designed to contain inflation, were insisted upon.

Secondly, the revenue target of 5.5 trillion rupees was unrealistic especially given the contractionary monetary and fiscal policies agreed between the Fund and the Pakistani team leaders that accounted for scaling down the growth projection to a mere 2.4 percent this year pre-Covid-19. This in turn led to large-scale manufacturing sector laying-off workers, again pre-Covid-19, and/or a salary reduction in several private sector-operated subsectors. In other words, almost 80 to 90 percent of those engaged in the private sector have either lost their jobs and/or have been subjected to a salary cut of a minimum of around 15 percent. In this scenario for the government to resist keeping the salaries of government employees' constant, leave alone slash by an extremely reasonable one percent, may be untenable.

The IMF agreed to a budget deficit of 7.2 percent for the current year, the same as for last year projected by the government in May 2019. However, this projection was understated by 1.7 percent, the actual deficit for the previous year was 8.9 percent of GDP. The Fund in its first review report upgraded the deficit to negative 7.6 percent, a gross underestimation given that the Fund insisted that the government meets its budget obligations to release the amount earmarked for Public Sector Development Programme (PSDP) (at the time of the first review only 8 percent of the budgeted amount had been disbursed) and for social development, including 'Ehsaas' which was stalled due to an ongoing survey, that had released a mere one percent of what was budgeted till that time. At the same time, the need to downgrade the unrealistic tax revenue target was accepted by the IMF and the target was reduced to 4.2 trillion rupees.

It appears that the Fund reckons the additionality in the Covid-19 rupee 1.2 trillion package is 519 billion rupees, the increase in external borrowing for the current year to meet this challenge is 2 billion dollars (already available from multilaterals), while the revenue target has been reduced to 4.6 trillion rupees though the government's projection is 3.9 trillion rupees. The actual impact of Covid-19 on the economy therefore remains to be quantified as the pandemic continues to rage in the country while the Fund has already projected key targets in the document on Pakistan's request for Rapid Financing Instrument which is being seen by the Ministry of Finance as EFF revival conditions. Negotiations are ongoing and one would assume that the budget formulation for next year would be an extremely challenging exercise however belt tightening must be a major component and the monetary and fiscal policies must be targeted towards growth rather than on stifling an economy already reeling from extremely low output.