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Covid-19 and Pakistan's economy, Way forward-II

Pakistan's fiscal situation has worsened significantly during the second lost decade (2008-18) and the deterioration further accelerated over the last two years (2018-20) owing to the implementation of an IMF programme as well as Covid-19. Tax collection was severely affected during the period of lockdown (April-June) on the one hand and expenditure surged on the other, primarily due to the high interest rates and devaluation of rupee under the programme and relief measures taken by the government to protect the poor through the Ehsaas programme. As a result of the poor performance of tax revenue and surge in expenditure, the overall budget deficit increased to 9.0 percent of GDP in 2018-19, but declined to 8.1 percent of GDP in 2019-20 owing to the extraordinary generosity of the SBP which contributed 2.2 percent of GDP as their profit which appeared as non-tax revenue in the budget.

Overall, inflation in general and food inflation in particular remained at the elevated level during 2019-20 owing to the disruption of supply chain and overall lockdown to prevent the spread of the Covid-19 on the one hand and massive devaluation of the Pakistani currency under the IMF programme on the other. Food inflation in particular has had a devastating impact on the poor as well as middle income families. Food inflation has persisted in the range of 15-16 percent per annum since August 2019. Such a prolonged period of high food inflation has seldom been observed in Pakistan. The factors responsible for the persistence of high double – digit food inflation include: less production of wheat (24 million tons), not releasing wheat to flour mills when flour pries kept on rising, lack of capacity to take timely decisions to import wheat, lack of understanding on the part of economic team to handle the issue and absence of seriousness on the part of the government to address the challenges.

While Covid-19 adversely affected growth, investments, unemployment, poverty, revenues, expenditure, budget deficit, and public debt, it has positively impacted Pakistan's external sector. Imports were already on the decline even before the pandemic, it further accelerated the downturn for two reasons. Firstly, the ongoing IMF programme had suffocated the economic activity in the country resulting in a decline in imports. Secondly, Pakistan being the net importer of oil, benefited immensely due to an unprecedented decline in international prices of oil. The average international price of oil was $67.9 per barrel in 2018-19 but declined to an average of $53.6 per barrel in 2019-20—a decline of over 21 percent, thus saving $4.7 billion from oil imports. The combined effects of slowing economic activity and the decline of oil prices resulted in the reduction of $9.5 billion (or 18.3%) imports in 2019-20.

Exports were also on the decline even before the arrival of Covid-19; the pandemic further accelerated the decline during the last quarter of the fiscal year 2019-20. Contrary to the general belief, remittances, instead of declining, in fact increased by 6.5 percent to $23.1 billion in 2019-20. It is too early to make a judgement about the reason (s) for the increase of remittances.

The overall current account deficit witnessed a massive decline from $13.4 billion in 2018-19 to $3.0 billion in 2019-20 — an improvement of a hefty $10 billion or 3.7 percent of GDP. As a result of the improvement in current account deficit, the country's foreign exchange reserves increased from $7.3 billion a year ago to $12.1 billion in 2019-20 – an increase of almost $5 billion.

While the pandemic has caused unprecedented damage to global economy, it has effectively improved the country's balance of payments. The current account deficit shrank, the country's foreign exchange reserves improved, Pakistan received $1.4 billion from the IMF's Rapid Financing Instrument; it also received approximately $2.0 billion in debt relief from the G-20 and most importantly, Pandemic caused the suspension of the IMF programme. The challenge lies with the government to protect these gains on balance of payment. In the last few months, we see once again a surge in non-essential imports and if not checked, there is a danger that these gains on balance of payments may be wiped out in the ongoing fiscal year.

Way Forward

Pakistan's economy is struggling to come out of the adverse effects of Covid-19. A relative stability is prevailing in the economy for three reasons. Firstly, the virus has slowed considerably in relation to the months of April-July 2020. As opposed to a daily average of 5500-6000, the number of cases slowed to an average of 550-600 during August-September which gave private sector confidence to resume their businesses. However, during last one month, Pakistan is witnessing a surge in cases which are still in the range of 2000-3000 and if not checked, there is a danger that this may damage the hard earned stability.

Secondly, the IMF programme has remained suspended since February 2020 and with this suspension come the suspension of 'hara-kiri', that is, the usual stuff of the programme which include raising utility (electricity, gas) prices, raising discount rate and devaluation of the Pakistani rupee. The suspension of 'hara-kiri' has brought stability and predictability of policies which further boosted the confidence of the private sector.

Thirdly, the State Bank of Pakistan (SBP) reduced the discount rate by 6.25 percentage points in phases, largely under the pressure of independent economists, print and electronic media and partly to minimize the adverse effects of Covid-19. In addition, the SBP pumped money into economy to ease liquidity constraints of the private sector. The government, on the other hand, provided extra-ordinary incentives to revive construction activity in the country.

All the above listed measures have succeeded in restoring the confidence of the private sector to a greater extent. These measures have brought stability and predictability in government's policies which must not be destroyed by reversing the above-listed measures. Going forward, the government may consider the following actions to revive the economy.

Firstly, the government must hold hands of the businesses at all level – small, medium, and large. This is not the time to increase the costs of doing business by raising the utility prices (gas, electricity). Furthermore, the Central Bank (SBP) must consider reducing discount rate further to 5.0 percent from the current level of 7.0 percent. Discount rate must be kept at less than the core inflation rate, that is; pursue a negative real policy rate to bring debt situation under control.

Secondly, agriculture has remained neglected for over 12 years by successive governments. As a result of which the per capita availability of wheat per annum has declined from 145 kg to 120 kg. Our wheat production has failed to maintain the pace of country's population growth rate. Shortage of wheat on the one hand and not importing wheat on time have led to a surge in wheat/wheat flour prices. Surge in flour prices has caused substantial increase in food inflation. How to increase wheat production should be the main policy agenda of the government.

Thirdly, Pakistan was the fourth largest cotton producing country in the world. It used to produce 13-14 million bales of cotton, the production of which has declined to 9 million bales in 2019-20 and there are indications that the cotton production would substantially decline in current fiscal year as well. What has happened to cotton production? This should be the task of the government to find out the reasons by holding wide-ranging consultation with the stakeholders.

Fourthly, Pakistan's balance of payments position has improved significantly in the current fiscal year. However, the trends in import are threatening to undo this improvement. Unnecessary imports have once again started rising with threatening pace. For example, the imports of cell phones have increased from $224 million in the first quarter of last fiscal year to $527 million in the first quarter of the current fiscal year, thereby registering a growth of 135 percent. This is a dangerous trend and if not checked, the hard-earned improvement in balance of payment will simply evaporate. A selective and yet aggressive import compression policy must be pursued to discourage luxury or unnecessary import.

Fifthly, Pakistan must pursue import substitution policy in agriculture and manufacturing to save foreign exchange for which, a 'Permanent Committee on Import Substitution (PCIS)' may be established with active participation from private sector.

Sixthly, if it is absolutely necessary to revive the IMF programme, the Pak authorities must insist for no more hike in utility prices, discount rate and no 'hara-kiri' in exchange rate. The programme should exclusively concentrate on reforms – reforms in power sector (by raising electricity prices is no reform, it is simply maintaining the status quo, which is not acceptable), tax system and tax administration, industries, and agriculture. Reforms in the SBP for giving more autonomy as proposed by the IMF, are like creating state within State and, therefore, must not be accepted. The IMF on its part must consider the prevailing global economic situation and must not force Pakistan to undertake policies which will hamper economic recovery. On the autonomy of the SBP, the country's central bank is more autonomous than many Central Banks in Asia-Pacific and Latin American countries (Empirical Evidence is available with the author). Therefore, the IMF must avoid creating 'state within state'.

Seventhly, given the all-time low interest rate environment in the World, this is an opportune time to float sovereign bonds to raise foreign exchange and build the country's forex reserves. Pakistan should consider floating at least two sovereign bonds (Eurobond, sukuk) in the current fiscal year, preferably one of 10 years and the other one of 5 years maturity. Perhaps a 10-year Eurobond and a 5-years Islamic bond (sukuk) would be an ideal combination.

Finally, making the Special Economic Zones under the China-Pakistan Economic Corridor (CPEC) functional should be the topmost priority of the government. This will promote industrialization and exports. The government has been accused of slowing down the work on CPEC–related projects. This is the time to dispel such impression.

(Concluded)

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