

## **The PML-N's economy: Part II**

Page NO.06 Col NO.04

The remarkable performance achieved in the first three years of the PML-N government's tenure was squandered in the last two years. Economic management just slipped out of their hands.

The core instrument for economic managers is fiscal deficit. As we noted in the previous part of this article, the deficit was brought down to nearly 4.6 percent in 2015-16 from a high of 8.2 percent in 2012-13. However, it shot up to 5.8 percent during 2016-17, the first year after the IMF programme. Two things had catapulted the fiscal performance. The FBR's revenues majorly slowed down, with only an eight percent nominal growth compared to the 18 to 20 percent growth registered during 2013-16.

Some non-tax revenues also fell significantly short of their target. Provincial surpluses were wiped out to the extent that there was a negative surplus. The deficit of 5.8 percent was made possible because of a number of one-off revenue items, adding up to 0.6 percent of GDP. This meant that the underlying deficit was close to seven percent, which was a reversal of the gains achieved in the first three years.

The situation was repeated during the current fiscal year. At the time of the budget, the deficit was targeted at 4.1 percent. The revised estimate announced in the 2018-19 budget, on April 27, was 5.5 percent, showing an overrun of 1.2 percent. The actual deficit for July to April was recorded at 4.3 percent. There are reasons to believe that the full-year deficit would very likely be close to 7 percent.

These include: (a) FBR's revenues are likely to be short compared to revised estimates; (b) performance of non-tax revenues is significantly short compared to the budget; (c) provincial surplus is highly unlikely to materialise – just like last year; (d) high expenditures on development (notably for parliamentarians); and (e) numerous unbudgeted expenditures such as exporters incentive package. In fact, if one estimates deficit from the financing side (government borrowings), it is clear that a deficit close to 7 percent is very likely.

The debilitating effects of fiscal deficit are more poignantly reflected in the external account. In the previous part, we had noted that in the third year, current account deficit was only 1.7 percent of GDP and the country had achieved historic reserves of \$24.5 billion. Just as fiscal deficit shot up to 5.8 percent in 2016-17, the current account deficit rose to 4 percent – more than double from a year earlier.

To finance such a large deficit, the country chose to rely on commercial borrowings with short-to-medium-term tenures. However, these were insufficient. Inevitably, the process of drawing down on reserves, so painstakingly accumulated, was triggered. The funding was not available from International Financial Institutions as the country abandoned economic reforms and engaged in fiscal profligacy. In this backdrop, the fourth year saw reserves decline and fiscal and external account deficits rise, in sharp contrast to the performance of the first three years.

This trend further worsened in the current and final year of the government. Now, the current account deficit has increased to six percent of GDP – highest in more than 10 years. The reserves have plummeted to a dangerously low level. It is incredible to see how quickly the reserves were either lost or fresh debt was contracted to continue to live a life of profligacy. This needs some explanation.

The highest official reserves were recorded on September 30, 2016, at \$20 billion (gross reserves \$24.5 billion). The public external debt at the time was \$58.7 billion. In June 2013, the level of debt was \$48.1 billion. Thus, until then, over the first three years and a quarter, the PML-N government had added \$10.6 billion to the debt. However, during the same period, the reserves had increased from \$6 billion (gross \$11 billion) to \$20 billion (gross \$24.5 billion), a net increase of \$14 billion – significantly more than the increased debt of \$10.6 billion. This should not be surprising as under the IMF programme nearly all borrowings were subject to an adjuster – the target would increase by the amount of borrowing.

Let's now contrast the situation that developed October 2016 onwards. The external debt as on April 31, 2018, was \$69.3 billion – showing an addition of \$10.6 billion in the debt outstanding on September 30, 2016, namely \$58.7 billion. Additional borrowings of at least \$1.5 billion were made during April to May. This gives a \$12.1 billion net addition in debt.

Now let's see what is happening to the reserves. The latest number available for May 18, 2018 was \$10.3 billion. So, here is the equation: We lost \$9.7 billion in reserves (\$20-\$10.3) and have accumulated an additional debt burden of \$12.1 billion. This is in sharp contrast to the performance under the Fund programme. Since June 2013, the government has added \$22.1 billion in external debt during the last five years, while the net increase in reserves amounts to a meagre \$4.8 billion.

In its first post-programme monitoring report, the IMF had indicated that the level of net international reserves (NIR) was negative \$763 million as on December 31, 2017. Since then, things have further deteriorated. When the Fund programme was negotiated back in June 2013, the NIR was close to negative \$2.5 billion. It seems that the country has come full circle to the same level after five years.

Moreover, the reforms programme was completely abandoned. Privatisation was halted and circular debt surpassed even its past level, government borrowings from the State Bank of Pakistan knew no bounds, the share of short-term debt rose to a dangerous level and the policy rate and exchange rate were not responsive to market

needs. There was, so to say, an indifference to what was happening, as the government let the economy run on the auto-pilot mode.

As the term of the government expired, we saw that most of the gains it had made in the first three years had been neutralised. Its performance on key policy variables is like an inverted U-shaped curve. However, there is one major difference from 2013, the reforms of the first three years have engendered a growth momentum that is unprecedented in the recent past and is still continuing. This momentum is threatened by the worsening fiscal and external imbalances.

Unfortunately, the government will bequeath to its successors an economic situation which is no different than what it inherited in 2013. The country will start another cycle of painful economic adjustments which would require significant cut in fiscal deficit, policy rate and depreciation in the exchange rate. And there is no doubt that ordinary people will suffer.

Concluded

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