DAWN

What to expect in the 'mini-budget'

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IN CONSULTATION with the International Monetary Fund (IMF), the government is looking at fiscal adjustment of 1.5 to 2 per cent of gross domestic product (GDP), or Rs600-750 billion, when it seeks amendments to federal budget 2018-19 that was announced by the PML-N government in May this year.

This comes with a massive cut in development expenditure to the extent of over one per cent of GDP and through the withdrawal of tax and duty exemptions. Together this would tighten growth close to 1pc of GDP and push inflation about two notches higher to 8pc with prices of at least 500 items going up.

These actions need to be undertaken prior to formally engaging with the Fund for a policy level dialogue and a smooth transition into a new programme. The government expects to get through the amended financial bill by end of this month so that changes become effective on the first of October 2018. The IMF will field a staff mission to Islamabad by next weekend.

After budgetary re-adjustment, the government will need to negotiate the timelines for long outstanding structural reforms, particularly the schedule for privatisation of public sector entities and the taxation system as upfront deliverables of the fund programme.

The combined impact of even a minor setback to economic growth coupled with higher inflation will, however, pinch the common man in the short to medium term

While development cuts have been a traditional tool to contain fiscal deficit in Pakistan, this will be perhaps the first time that tax benefits given to individual tax payers will stand to be withdrawn so soon after they have come into force. Disbursements for the development programme have already been completely stopped for the time being.

Consultative sessions continued until the last moment to deliberate completely banning the import of some 130-150 unnecessary items such as second hand cars, while increasing duty rates on others including luxury items such as expensive phones, jewellery and food items. These trade measures are estimated to have an impact of over $1 billion on the current account deficit.

The current cumulative cost of tax and duty exemptions is estimated to be to the tune of Rs550bn which the government aims to bring down to around Rs200bn, thus transferring an impact of almost Rs350bn back to the people.

In the process, a few tax exemptions (available to top office holders in section 51 and schedule II of the income tax law) that have a minimal fiscal impact but a strong symbolic value are also being proposed for withdrawal including those enjoyed by presidents, governors and officers of the judiciary and armed forces. The provinces will also be expected to enhance their cash surplus targets.

Accordingly, individual taxes and the targets for both direct and indirect taxes will go up substantially by almost 0.7-1pc of GDP; while higher inflation and the significant devaluation of the rupee against the dollar will give better yields on import duties.

The combined impact of even a minor setback to economic growth coupled with higher inflation will, however, pinch the common man over the short to medium term. This will be particularly painful owing to a simultaneous increase in gas and electricity rates with an additional fiscal impact of more than Rs350bn a year. This includes the proposed increase of Rs157bn worth of natural gas rates and over Rs200bn in electricity rates.

While increased energy rates will generate funds for the troubled gas and electricity companies, these will also yield additional revenue of about Rs60bn to the government. Therefore, the people will have to bear the additional burden of more than 3pc of GDP or over Rs1.1 trillion during the fiscal year.

A major initiative expected as part of the budgetary realignment is the amendment to incomes and assets made in violation of the income tax law, SBP Act, SECP Act, and Nab laws etc so as to effectively address the challenge of Benamis, money laundering and terror financing to target illegal or unjustified wealth of Pakistani's abroad.

The government expects the combination of these measures will largely address the twin fiscal and current account deficit challenge. The last fiscal year concluded with a mammoth fiscal deficit of 6.6pc of GDP (Rs2.260tr) and a record $18bn (5.7pc of GDP) current account deficit.

The government's decision for sharing the new budgetary and trade measures with the IMF is to enable the two sides to shrink the duration for a policy dialogue before the annual meetings of the Fund and the World Bank which are scheduled for October 8-14 in Bali, Indonesia.

The mega event will enable the Finance Minister Asad Umar led Pakistani delegation to engage with the top management of the multilateral lenders on the sidelines to get the deal done at the earliest. US secretary of state Mike Pompeo is reported to have promised not to oppose an IMF bailout to Pakistan, according to Minister for Information Fawad Chaudhry.

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