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SOUTH ASIA CENTER

ISSUE BRIEF

Beyond Pakistan's 2021-22 Budget: the economy and growth

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The **South Asia Center** serves as the Atlantic Council's focal point for work on greater South Asia as well as relations between these countries, the neighboring regions, Europe, and the United States. It seeks to foster partnerships with key institutions in the region to establish itself as a forum for dialogue between decision-makers in South Asia, the United States, and NATO. These deliberations cover internal and external security, governance, trade, economic development, education, and other issues. The Center remains committed to working with stakeholders from the region itself, in addition to partners and experts in the United States and Europe, to offer comprehensive analyses and practicable recommendations for policymakers.

On June 29, 2021, Pakistan's National Assembly passed the country's 2021–2022 budget, which had been prepared and tabled by Finance Minister Shaukat Tarin. Recently appointed to his position, Tarin has positioned the budget as being growth oriented in focus, with significant increases to subsidies, public-sector development, and salaries of government employees. After successive budgets that had focused on austerity—in part due to the conditions imposed under the International Monetary Fund's (IMF) macroeconomic stabilization program—the Pakistan Tehreek-e-Insaf (PTI) government has signaled that it will increasingly focus on generating economic growth in the second half of its five-year term.

The budget, however, has raised concerns among domestic and international economic analysts, primarily due to its large spending increases and lack of focus on economic reforms that improve tax collection, rationalize energy tariffs, and reign in the burgeoning debt in the power sector, which has crossed the $14-billion level in recent months. Critics have also argued that, while the budget has created optimism in terms of growth prospects, it does not signal a commitment to taking credible steps to address major challenges that have created headwinds against sustainable growth. They also argue that the budget increases the risk of Pakistan abandoning its agreement with the IMF, potentially leading to higher borrowing costs in the international bond market and risking a repeat of previous economic crises that Pakistan has faced.

To talk about this budget and the broader prospects of sustainable growth in Pakistan, the Atlantic Council, the Center for Global Development (CGD), and the Pakistan Institute of Development Economics (PIDE) organized a private, off-the-record roundtable. This discussion was attended by economic

A shopkeeper serves a customer while selling dry fruits and grocery items along a market in Karachi, Pakistan June 11, 2021. REUTERS/ Akhtar Soomro

experts from within and outside Pakistan, and some of the key takeaways of the discussion are as follows:

- there was broad consensus that the budget reflected a break from the austerity-focused budgets that had been presented since the PTI-led government came to power in 2018;
- the assumptions and projections made in the budget are ambitious, especially as they relate to the government's ability to raise the fiscal resources necessary to meet its spending goals and achieve its fiscal-deficit target;
- ongoing negotiations with the IMF to continue the program are going to be challenging, given that the budget did not address many of the conditions agreed to with the IMF;
- increased government spending could lead to a broadening of the current-account deficit, leading to a decline in foreign-exchange reserves, and forcing the central bank to take proactive measures in order to deal with external-sector risks prior to an election; and
- there is a dire need for consensus among elected and unelected elites in Pakistan to reform the economy to chart a more sustainable and inclusive growth trajectory.

To address some of these concerns, Pakistan's policymakers can

- clearly signal that they are committed to continuing the IMF program and implement the conditions agreed to with the IMF;
- develop and showcase a credible and robust energy-sector reform program that seeks to address the circular-debt crisis in a sustainable way;
- execute policies that seek to incentivize export growth and diversity, with a particular focus on boosting information-technology exports, something which the finance minister has already said is a key area of focus;
- engage in a broad-based and inclusive dialogue with political and nonpolitical elites to forge a consensus on key reforms, particularly as they relate to reducing the government's distortionary role in the economy; and
- broaden the tax base to make privileged segments of society contribute a fair share of resources to the state and reduce the burden of regressive, indirect taxation on tens of millions of citizens and formal businesses.

While participants had a lot to say about the reasons why this was the case, the discussion did not focus significantly on the process through which reforms could be pushed, given the realities of Pakistan's political economy. This could, perhaps, be the focus of another roundtable discussion, especially given that most of the participants agreed on what ailed the economy.

A discussion focused on what the reform agenda should look like, how the government should go about implementing these reforms at a tactical level, and what measures it can take to sustain the pace of reforms given the realities of Pakistan's political economy could be an effective way to offer clear policy recommendations to policymakers within and outside the government. These recommendations could also be a starting point to engage with broader segments of society and educate them about how reforms, some of which may be costly in the near term, could improve their own personal lives in the medium term.

Austerity is over, for now.

Participants noted that the PTI-led government had its eyes on the upcoming elections in 2023, which is why it has presented a budget that seeks to increase the rate of economic growth. It was also noted that the country suffered from a lack of long-term growth policies for the last forty years, which had resulted in successive crises requiring austerity-focused budgets after a few years of growth. Given the lack of structural reforms, expansionary budgets soon created the conditions for the next crisis, creating the need for another stabilization program through an obsolete strategy for austerity and haphazard tax increases. Participants noted that successive governments, as well as the IMF and other donors, keep repeating the same budgeting exercises while expecting different outcomes. This lack of reform means that the state continues to play a major role in markets such as wheat, sugar, and fertilizers, protecting domestic industries from competition and distorting the economy.

Assumptions are not realistic, and will be tested in the coming months.

Participants also noted that there was a "feel-good" factor in the budgetary announcements and targets. This means that as the months go by, the ability of the government to meet these targets will be tested, especially as they relate to tax collection. Higher oil prices are already forcing the government to reduce the petroleum levy it collects from consumers. As these targets are not met, the government will be forced to cut spending and/or run higher deficits, for which it will need to borrow larger sums of money.

One area in which the situation is expected to worsen is the power sector, with the circular debt crossing $14 billion in recent months. The power-sector deficit has persisted through four IMF programs, and remains unresolved. The budget provides additional subsidies to the sector, and the lack of a robust plan to sustainably deal with the circular debt means that the government is likely to kick the can down the road. This means that the pressure to rationalize tariffs will continue to build over the medium term, creating significant risks for the broader economy. Participants also pointed out that the power sector needs serious structural reforms, and not mere tariff hikes.

IMF negotiations will prove challenging.

Pakistan is projecting significant budgetary support from the IMF and the international bond market, and the country's ability to raise funds from the latter rests on successful negotiations with the former. Participants noted that these negotiations are going to be difficult, since the budget simply ignored key aspects of the agreement between the IMF and Pakistan as part of the country's economic-stabilization program.

A shopkeeper uses a calculator while selling spices and grocery items along a shop in Karachi, Pakistan June 11, 2021. REUTERS/Akhtar Soomro

Some participants noted that the budget signaled a parting of the ways between Pakistan and the IMF, while others were of the view that broader regional developments—particularly as they related to the US withdrawal from Afghanistan—will play a role in determining the future of the program. Despite this difference of views, there was broad consensus that a continuation of the IMF program was necessary to maintain near-term economic stability in the country. At the same time, it was pointed out that the country needed to adopt a bold reform program that addresses decades-old weaknesses in the economy; these reforms would also signal to the international community that Pakistan is charting a course toward sustainable growth.

Reforms require domestic ownership and consensus.

Participants noted that successive IMF programs have proven that outside organizations cannot force Pakistan's elites to push difficult and costly economic reforms. While there is recognition that the status quo is increasingly becoming untenable, there is little to no engagement among political elites to chart a way forward for reforms. It was also noted that a significant reason for the lack of reforms was the fact that Pakistan's political system is unstable, leading governments to focus on maintaining power and refraining from making decisions that would be politically costly. This means that opportunities to push reforms are often lost chasing externally defined and misplaced policy targets. Participants pointed out that there was a clear need to develop policies at home that have broad ownership, creating the space for governments to make difficult decisions and sustain momentum for reforms.

Some participants raised the issue of elite capture in the country, arguing that there were no incentives for elected and unelected elites to push for reforms, given that they derived significant economic benefits from the status quo.

It was also mentioned that Pakistan had successfully extracted geopolitical rents, such as during the country's participation in the war on terrorism after 9/11, or through strategy allies, in the form of deferred oil facilities from Saudi Arabia and infrastructure-focused borrowing from China under the China-Pakistan Economic Corridor. So long as elites continued to enrich themselves from the status quo and found external sources of funding to maintain it, there was little to no incentive to reform. Other participants disagreed with this view, arguing that elite capture was the norm in economies around the world, including the United States.

Participants also flagged that sustainable growth can be achieved by improving Pakistan's integration with the global economy, particularly as it related to growing the country's exports. This, they argued, was critical to building resilience against external shocks, which have historically caused balance-of-payments crises that require interventions by the IMF and other multilateral donors.

Conclusion

The roundtable discussed a range of issues facing Pakistan's economy, and there was broad agreement that this budget is unlikely to sow the seeds for sustainable economic growth in the country. There was broad consensus that, by kicking the can down the road and focusing on the elections, the PTI government is only repeating the cycle of the past, where governments have generated short-term economic growth at the expense of long-term economic stability. A repeat of this cycle could generate another macroeconomic crisis leading up to, or right after, the 2023 general elections, forcing the incoming government to once again focus on stabilizing the economy.

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This issue brief was informed by a trilaterally hosted roundtable with the Atlantic Council's South Asia Center, the Pakistan Institute of Development Economics, and the Center for Global Development.

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This private roundtable was conducted with the understanding that no information from the discussion may be attributed to the relevant speaker(s). Attendees participated in their personal capacities. Affiliations listed solely for identification purposes.

Uzair Younus served as rapporteur.

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