

National Policy Responses to the Financial and Economic Crisis: The Case of Pakistan

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by

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Key Policy Areas:

The Government of Pakistan is pursuing tightening fiscal policies and monetary policies aiming at stabilization of the macroeconomic situation in the country and restoration of the investors' confidence.¹ The macroeconomic conditions in the country deteriorated significantly due to the domestic as well as international factors; global financial crisis among one of them. The real GDP growth is expected to slow down while growth in Pakistan's volume of trade is reduced in response to the tightening of macroeconomic policies in 2008/09. The inflation is expected to decline and the foreign exchange reserves position will be strengthened. To protect the vulnerable groups from these developments, government has initiated Benazir Income Support Program with the initial endowment of PRs 34 billion to provide income support to 7 million households. The major policy initiatives are highlighted below.

Fiscal policy: One of the main objectives of the fiscal policy is to reduce the fiscal deficit in the current financial year to a sustainable level of 4.2 percent of GDP from 7.4 percent in 2007/08. In monetary terms, government envisages to reduce the size of fiscal deficit by PRs 562 billion during the current year. This effort will help move economy towards a sustainable fiscal position, reduce the external current account deficit and eliminate government borrowing from the State Bank of Pakistan (SBP).

- To achieve this goal, the government plans to reduce its expenditure and increase revenues. In this regard, the tax revenue will be increased by 0.6 percentage points of GDP and non-interest current expenditure be reduced by about 1.5 percentage points of GDP. This reduction will be achieved mainly through the elimination of both oil and electricity subsidies by June 2009.

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¹ The main source of this information is the Ministry of Finance, Government of Pakistan.

- The government also announced to cut the domestically financed development spending by about 1 percentage point of GDP through better project prioritization during the current fiscal year. A number of steps are already implemented consistent with the planned fiscal adjustments. More specifically:
 - The subsidy on petroleum has already been completely eliminated by adjusting the petroleum prices three times since June 2008.
 - At the same time, electricity tariffs were adjusted by an average of 18 percent effective September 5, 2008.
 - In addition, steps have been taken to slow the pace of development spending.
 - The research and development subsidy for the textile industry has been fully eliminated.
 - Wheat procurement prices have been raised to international levels, and
 - The general sales tax (GST) rate has been raised by one percentage point to 16 percent.
- The targeted reduction in the fiscal deficit in 2008/09 will help eliminate the SBP financing of the budget. The government plans to reduce borrowing from SBP to zero to finance its spending from October 1, 2008 to June 30, 2009. During this period, the fiscal deficit will be fully financed by available external disbursements, the acceleration of the privatization process, the issuance of treasury bills, and other domestic financing instruments, including Pakistan Investment Bonds, and National Savings Scheme (NSS) instruments.
- A further reduction in the fiscal deficit to 3.3 percent of GDP is envisaged for 2009/10. The fiscal effort will be facilitated by the full-year effect of the elimination of energy subsidies by end-2008/09 and declining interest payments, following large bullet payments in the three-year period ending in 2009/10.
- Consistent with the government's objective of substantially increasing tax revenue, a number of tax policy and administration measures are envisaged. Specifically, an integrated tax administration organization on a functional basis will be established at

the Federal Board of Revenue (FBR) integrating both the income tax and sales tax administration. In addition, audits will be reintroduced as part of a risk-based audit strategy that is being implemented by end-December 2008. As part of this process, the government plans to harmonize the income tax and GST laws, including for tax administration purposes, and reduce exemptions for both taxes. To that end, it will submit legislative amendments to parliament by end-June 2009. In addition, the excises on tobacco will be increased in the context of the 2009/10 budget.

- The government's fiscal consolidation efforts will continue over the medium term. The government's fiscal framework assumes a further reduction in the fiscal deficit to 2–2½ percent of GDP by 2012/13. Fiscal consolidation will be supported by a strong tax effort, which will allow for higher spending in infrastructure and the social sectors. Specifically, the government is committed to increasing tax revenue by at least 3½ percentage points of GDP over the medium term as a result of measures to broaden the GST base, significantly reduce income tax exemptions, and further improve tax enforcement.

Monetary Policy: The government program to deal with the current economic situation envisages a significant tightening of monetary policy. To that end, the SBP recently increased its discount rate by 200 basis points, to 15 percent. Following this first step, interest rate policy will be sufficiently flexible to protect the reserves position, bring down inflation, and allow the government to place T-bills and other securities with commercial banks and non-banks in order to avoid further central bank financing of the budget.

- A further increase in the discount rate will be considered at the time of the monetary policy statement scheduled for end-January 2009. However, the discount rate were planned to be raised earlier if the actual reserves for end-November and end-December 2008 fall short of the monthly floors on the SBP's net foreign assets.
- The conduct of monetary policy is facilitated by significant improvements in liquidity management, including the improvement in the forecasting of the government's cash flow position.
- As part of these efforts, the SBP and the Ministry of Finance have agreed on quarterly volumes of treasury bill placements consistent with zero SBP financing of the budget

during October 1, 2008–June 30, 2009. The SBP has issued an auction calendar for November–December 2008 on November 1st, 2008, and in the future will issue a calendar every quarter one month in advance. In addition, the SBP will review the current procedures for liquidity management, and will adopt and publicize a transparent liquidity management framework by end-July 2009 as part of its Monetary Policy Statement. This framework will contain the following key elements:

- The announcement of an explicit corridor for money market interest rates: the SBP's reverse repo rate will be the ceiling, and a standing repo facility to absorb excess liquidity from commercial banks will serve as the floor of the proposed explicit corridor;
 - The treasury will provide the SBP with T-bills, as needed, to conduct its open market operations.
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- The SBP is pursuing a flexible exchange rate policy. To that end, intervention in the foreign exchange market (including the provision of foreign exchange for oil imports) will be aimed at meeting the reserve targets. This primary objective will be facilitated by phasing out the SBP's provision of foreign exchange for oil imports according to the following schedule:
 - Furnace oil—by February 1, 2009.
 - Diesel and other refined products—by August 1, 2009.
 - Crude oil—by February 1, 2010.
 - The SBP intends to eliminate any exchange restriction. Specifically, the exchange restriction on advance import payments against letters of credit will be eliminated by end-January 2010, subject to a marked improvement in the balance of payments position. No intensification of existing restrictions and no new exchange restrictions or multiple currency practices will be introduced during this period.
 - The SBP is preparing a contingency plan to deal with troubled private banks. The plan will contain criteria for SBP liquidity support, assessment of bank problems, and intervention procedures. The SBP has already dealt with problem banks through mergers. Looking ahead, if there are severe strains in the interbank market and interbank lending guarantees appear necessary, these guarantees will be provided in limited amounts only to solvent banks.
 - To enhance the effectiveness of SBP enforcement powers, necessary amendments to the

Banking Companies Ordinance will be submitted to Parliament by end-June 2009. These amendments will strengthen the SBP's ability to (i) change management in banks; (ii) impose losses on shareholders by writing down their capital; (iii) intervene and take ownership of banks; (iv) appoint administrators to operate banks; and (v) restructure banks.

- The government is expecting a positive outlook of the economy after securing financial support from the IMF in November 2008. This has already improved the foreign exchange reserves position of the country and that is expected to improve the market confidence.

Social Safety Nets: An expanded and effective social safety net constitutes an integral part of the overall government stabilization program. In this regard, several measures are envisaged to protect vulnerable groups that might be adversely affected by inflation and the economic slowdown.

- The fiscal program for 2008/09 envisages an increase in social safety net spending of 0.6 percentage points of GDP, to 0.9 percent of GDP.
- To this end, the government has launched the Benazir Income Support Program (BISP), for which the budget already allocated PRs 34 billion (0.3 percent of GDP). The design of the BISP, in particular the targeting of transfers and the delivery mechanism, will be reviewed in the first half of 2009, in consultation with the World Bank.
- The government also plans to expand social safety net spending by an additional 0.3 percent of GDP, for which further external assistance (mainly in the form of grants) is being sought from donors. While a more comprehensive and better-targeted social safety net is being designed, these additional funds will be allocated to scale up other existing programs, in particular cash transfers under the Bait-ul-Mal program. Also, part of the additional resources could be used to cover larger than envisaged electricity subsidies for poor households.

Other Initiatives: I did not come across any important policy initiatives to deal with and safeguard the employment in sustainable enterprises, protecting workers' rights and role of tripartite cooperation in policy response. These issues will be covered in the final report.