

Book Reviews

Planning Commission. *Report of the Panel of Economists: Interim Report on Economic Stabilisation with a Human Face.* Islamabad: Government of Pakistan. 31 October 2008.

In September 2008, as the newly elected government struggled to restore macroeconomic stability, the Planning Commission of Pakistan constituted an advisory Panel of eminent economists to “come up with both short and medium term policy actions to address the economic challenges facing Pakistan, especially in the context of the global economic downturn”.¹ The Panel was further advised by the Prime Minister to “suggest a short-term policy package to restore macro-economic stability which is efficient and equitable”.²

The Panel had less than six weeks to come up with its initial recommendations. The government was at the same time in deep negotiations with the IMF for a rescue package as the balance of payments situation became more precarious by the day.

The Interim Report of the Panel was to serve a two-fold purpose. First, to be drawn upon as required by the economic team headed by the Minister of Finance in their negotiations with the IMF. Second, to the extent the Panel supported the need for stabilisation measures, it would strengthen the government’s hand in building-up public support for stabilisation measures to be adopted.

The Panel came up with its Interim Report in end-October 2008 and proposed adoption of, “stabilisation measures that preserve economic growth to the possible extent and specific steps that would protect the poor and vulnerable groups”. The Report was presented and discussed in a full extended Cabinet meeting presided over by the Prime Minister. At the same Cabinet meeting, the Finance Minister presented the main elements of the proposed IMF Stand-By Agreement. Both the Panel’s Interim Report and the draft IMF Agreement were adopted by the Cabinet. The latter was formally signed in November 2010 after approval by the IMF Board of Directors.

The Interim Report of the Panel in this context must be viewed as an important—indeed ‘historical’ report. For the first time the country’s leading economic experts, in an independent advisory role, had put together a ‘home-grown’ stabilisation package which was given serious consideration by the government and deliberated at the highest echelons i.e. by the Cabinet.³

¹Ibid Preface, p. (iii).

²The Panel was set-up by Mr Salman Faruqi, Deputy Chairman Planning Commission and included as members: Dr Hafiz A. Pasha, (Chairman), Dr Rashid Amjad (Convener), Dr Naved Hamid, Dr Aisha Ghaus Pasha, Dr Akmal Hussain, Dr Akhtar Hassan Khan, Dr Ijaz Nabi, Dr Naseer Ali Khan, Mr Riaz Riazuddin, Dr Rehana Siddiqui, Dr Ali Cheema, Dr Asad Sayeed, Prof. Muhammad Tousif Akhter, Mr Sakib Sherani and Dr Qazi Masood Ahmed. The following were co-opted as members: Dr Azam Chaudhry, Dr Ather Maqsood, Syed Kalim Hyder Bukhari, Mr Muhammad Sabir and Mr Savail Hussain.

³The Panel also separately presented its report to the President of Pakistan before the Cabinet meeting.

The Panel's Interim Report was divided into two parts. Part I presented a short-term stabilisation programme covering the next one and half years between 2008-10. Part II, dealing with growth recovery and development priorities, presented the main elements of a medium-term development strategy. Since the final report of the Panel (submitted much later) dealt in detail with the proposed development strategy, in this review we basically analyse Part I of the report i.e. the short-term stabilisation package covering: (i) macro framework; (ii) main policy measures proposed; (iii) expected economic impact on key macro economic variables.⁴ We then also conduct a brief ex-post evaluation based on actual economic outcomes.

It should be said up front that the Panel saw the stabilisation programme as one which would basically be V-shaped in its economic impact. "The guiding principle is a short sharp reduction in growth in the short-term and a quick rebound back to a higher trend growth rate".⁵ This scenario as it turned out proved to be more than optimistic though, in all fairness as 2009-10 drew to an end, there were signs of economic optimism as the economy responded favourably to the stabilisation measures adopted.

The Panel's proposed stabilisation and reform programme was based on the following four principles:

- *Mobilisation*: No effort to be spared, as the Panel stated, to mobilise domestic resources and cut expenditures to reduce the resource gap to manageable levels.
- *Protection*: The stabilisation programme must ensure that the vulnerable and the poorest are protected via cost-effective social safety nets.
- *Prioritisation*: Stabilisation and the reform programme built on it must demonstrate the ability to utilise domestic and external resources well.
- *Integrated Strategy*: Short term measures must be part of an integrated economic package that would pave the way for sustainable and equitable economic growth in the medium term.

The proposed stabilisation measures to reduce the current account gap and fiscal deficit included:

- Reducing current expenditure by Rs 115 billion by savings in defence expenditure, in subsidies, in debt servicing and others;
- Mobilising Rs 75 billion through **additional taxation** proposals including (a) regulatory duties on non-essential imports (4 percent on machinery and 8 percent on other items); (b) services tax on 12 selected services initially; (c) levy of an excise duty on non-essential consumer goods and durables; (d) capital gains tax on properties by provincial governments; (e) withdrawal of exemptions on income tax; (f) development of agriculture income tax by the provinces (now that farmers were getting world prices); (g) equating the top marginal rate of income tax with the corporate tax rate; (h) reducing threshold companies for the purpose of corporate taxation; and (i) reduction of thresholds pertaining to sales tax.

⁴The Panel Macro Team that conducted this exercise was led by Dr Hafiz Pasha.

⁵Interim Report of the Panel of Economists, p. 4.

- Tightening monetary policy by enhancing the SBP discount rate in **one go** by 2 percentage points and increasing reliance on non-bank borrowing to finance (upto Rs 250 billion) the budget deficit;
- Reduce the PSDP (Public Sector Development Programme) by Rs 100 billion (10 percent from federal and provincial PSDP) but safeguard social programmes and adjust allocations to public projects (with lower capital-output ratio and higher employment intensity) that would allow growth to bounce back quickly.

The Panel envisaged the following impact on the economy of the proposed measures.⁶

- GDP growth will fall to 4.4 percent in 2008-09 (compared to 5.8 percent in 2007-08)⁷ against 5.5 percent planned in 2008-09. This will increase to 5.1 percent in 2009-10.
- Balance of payments gap reduced to US\$ 4.5 billion in 2008-09 (from US \$ 6.2 billion in 2007-08) and largely eliminated in 2009-10. Growth of exports will take exports to \$ 23.5 billion by 2009-10. Imports are expected to decline to \$ 31.4 billion in 2008-09 from the target of \$ 35.4 billion. Remittances will continue to show rapid growth; foreign investment is expected to fall in 2008-09 and rise once again in 2009-10 to \$ 5 billion.
- Fiscal deficit falling to 4.5 percent of the GDP in 2008-09, from 7.4 percent in 2007-08 and further to 4.0 percent in 2009-10.
- No real growth in PSDP 2008-09 (as compared to 2007-08) resulting in a nominal reduction of Rs 63 billion in current PSDP in 2008-09 (covering both federal and provinces).
- Unemployment increases to 6.5 percent in 2008-09 (from 5.3 percent in 2006-07) adding 1 million to the number of unemployed.
- Poverty incidence increases, mainly due to high inflation and higher food prices.
- Price inflation (CPI) was estimated at around 22 percent in 2008-09 falling to below 17 percent in 2009-10.
- Exchange Rate was expected to depreciate over 2008-09 and remain stable in 2009-10.

An important feature of the Panel's stabilisation package was the protection to the vulnerable or "The Human Face of Stabilisation" as it was called. With lower GDP growth and the expected increase in unemployment, the numbers below the poverty line were expected to increase by about 5 million i.e. from around 30 million to 35 million. To help cushion this expected impact of the stabilisation package on the poor and the vulnerable the Panel suggested:

- To increase allocations to the newly introduced BISP (Benazir Income Support Programme) to cover 5 million households from Rs 56 billion to Rs 84 billion (with resources to be made available from the cut in the PSDP).

⁶In tracing the macro effects, the Panel combined the Planning Commission Consistency Macro Model with behavioural equations estimated from the SPDC (Social Policy and Development Centre, Karachi) growth model.

⁷The economic growth rate of 5.8 percent for 2007-08 was revised in the subsequent two years and the final figure is 3.7 percent for 2007-08.

- Allocate Rs 10 billion from the PSDP for a “national employment guarantee programme” in poor districts.
- Ensure that the People Works Programme for which Rs 28 billion had been allocated in the PSDP 2008-09 be spent mostly on employment-generating projects in a cost effective manner.

With hindsight it may be useful to see to what extent the suggested measures were actually put in place and to what extent the economy in fact responded to these measures?

Before we do this, however, it may be important to compare the Panel’s suggested stabilisation programme and the initial IMF 2-year US \$7.6 billion Stand-By Agreement which the government signed in November 2008, which was later enhanced in August 2009 to US\$11.3 billion over 3 years.

Interestingly there was not that much difference between the Panel and the IMF proposed stabilisation package and the main policy measures proposed to tighten economic demand were broadly the same. The IMF programme also included safety net measures in the form of allocation to the BISP (and to compensate for this the targeted fiscal deficit was relaxed for 2008-09).

The macroeconomic growth framework of the IMF over the next two years starting 2008-09 was also not that different from the Panel’s (see below):

Table

Macroeconomic Framework

	2007-08 Actual	2008-09 (P)		2009-10(P)	
		Panel	IMF	Panel	IMF
GDP Growth	5.8*	4.4	3.4	5.1	5.0
Fiscal Deficit	-7.4	-4.5	-4.2	-4.0	-3.3
Current Account Deficit	-8.4	-5.5	-6.5	-4.4	-5.7
Inflation (CPI)	2.0	22%	23.0	>17%	13.0

Source: (i) Interim Report of the Panel of Economist.

(ii) IMF Country Report No.08/364.

*Final figure was revised to 3.7 percent.

What Actually Happened During 2008-09?

Not just in response to the economic tightening but the onslaught of the global slowdown and rising crippling energy shortages, economic growth slumped in 2008-09 to much below than envisaged to 1.7 percent (true this figure is not comparable to the Panel and IMF projections which were based on estimated growth of 5.8 in 2007-08. However, in terms of relative growth compression the fall was much more drastic than envisaged by both the Panel and the IMF).

Inflation sharply rose as projected by both the Panel and IMF to over 20 percent in 2008-09 as overdue oil price adjustments were made to cover rising imported energy costs. Also the unprecedented increase in wheat procurement price to Rs 950/40kg for the Rabi 2009-10 as compared to Rs 625/40kg a year before fuelled food inflation which in turn was a major factor in driving overall inflation (CPI).

The current account deficit narrowed, as projected by the Panel and the IMF, as economic growth shrunk and the global recession brought relief to the import bill in the form of lower oil and commodity prices.

The PSDP was reduced more sharply than had been envisaged in 2008-09 because of much higher than expected non-development expenditures (mainly defence and security, continuing high subsidies) and this overrun continued in subsequent years. The fiscal deficit target was therefore not met with an actual fiscal deficit at 5.3 percent in 2008-09 as compared to projected 4.5 percent by the Panel and 4.2 agreed upon with the IMF. The fiscal deficit target for the subsequent two years was also not met which eventually led to the cessation of the IMF Stand-By Agreement in Autumn 2011.

As to the safety net measures proposed, the BISP was gradually put in place by the Federal Government through the amount actually spent and households coverage was much less than either planned by the government in 2008-09 or as recommended by the Panel.⁸ The Panel's recommendation of an employment-guarantee scheme was not adopted. However, a number of measures on a smaller scale to protect the poor were put in place by the respective Provincial governments.

On the whole, Pakistan's experience with the stabilisation programme adopted in October 2008 was reasonably satisfactory given the difficult security situation and a newly-induced coalition government struggling to ensure economic consensus on stabilisation measures. The lack of political will to introduce much needed economic reforms, especially revenue generating measures,⁹ and resulting high fiscal deficits led finally to Pakistan withdrawing prematurely from the IMF Stand-By Agreement.

The "home grown" stabilisation package proposed by the Panel did serve its purpose—in that the initial attempt at stabilising the economy was successful. Also the fact that the country's leading economists had an important input into the design of the stabilisation programme adopted was a "first". It is against this bar that the well-crafted report of the Panel of Economists must finally be judged.

Rashid Amjad

Pakistan Institute of Development Economics,
Islamabad.

REFERENCE

IMF (2008) Pakistan: Request for Stand-By Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion and Statement by the Executive Director for Pakistan. (IMF Country Report No. 08/364) (www.imf.org/external/pubs/ft/scr/2008/cr.08364.pdf).

⁸This shortfall was mainly due to the administrative difficulties in setting up such a huge programme from scratch.

⁹Most of the revenue generating measures proposed by the Panel were either not or only partially adopted. This was especially true of the proposed start of taxing agricultural incomes by the provincial governments.