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Economic Impact of a Pandemic: Pakistan Grapples with COVID-19

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Summary

Pakistan has the highest number of COVID-19 cases per capita in South Asia. As it confronts a health crisis, the country also finds itself grappling with the impact of the pandemic on its gross domestic product, export sector and current account deficit. The pandemic has already resulted in the first annual contraction of Pakistan's economy in 68 years and is threatening to exacerbate its economic vulnerabilities. This paper assesses the impact of the pandemic on Pakistan's economy and examines the steps taken by the federal and provincial governments to mitigate this. It also critically analyses how the pandemic has and will impact its ability to raise revenue and balance its fiscal deficit.

With more than 163,000 confirmed cases, Pakistan has the highest number of COVID-19 cases per capita in South Asia. Particularly alarming is the speed at which the virus is spreading. Government officials have warned that the number of cases might multiply eightfold and cross 1.2 million by August 2020.[1] The country's health infrastructure is being severely tested by the pandemic. The pandemic is also threatening to exacerbate Pakistan's economic vulnerabilities. Of course, such challenges are not unique to Pakistan. The rapid spread of COVID-19 in the United States and Europe reflects how the virus is testing health resources and economic structures globally. In the case of Pakistan, the pandemic has already affected the country's gross domestic product (GDP) and employment rates, and is threatening to adversely impact the country's fiscal and trade deficit.

Indeed, steps taken by the federal government to check the spread of the COVID-19 virus have themselves been stymied by the threat of economic disruption. Prime Minister Imran Khan has been candid in stating that he is opposed to lockdowns as he was concerned by the economic toll of taking such a step. He warned that it would particularly affect "twenty-five percent of Pakistanis [who] are below the poverty-line". He highlighted the impact that this would have on daily wage earners, rickshaw drivers and small shopkeepers and stressed that "if Pakistan was in a similar [financial] condition as Italy, France, America and England, I would completely lockdown Pakistan."[2] Concerns over the economic impact of a lockdown resulted in the provincial and federal governments often expressing differing views on how to tackle the crisis; with some among the former pushing for lockdowns and the latter speaking in the terms of "smart" and "selective" lockdowns".

As in other countries, the pandemic has already had a disruptive impact on Pakistan's economy. It has resulted in the first annual contraction of Pakistan's economy in 68 years.

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1 'Covid-19 cases could reach 1.2 million', *Dawn*, 14 June 2020. https://www.dawn.com/news/1563477/covid-19-cases-could-reach-12million-by-end-july-warns-asad-umar. Assessed on 15 June 2020.

2 'PM Imran says more sectors to be opened', *Geo TV*, 1 June 2020. https://www.geo.tv/latest/290815-pm-imran-says-more-sectors-to-be-opened-as-coronavirus-cases-surge-past-74000. Assessed on 1 June 2020.

Furthermore, despite incentives offered by the government to employers not to fire employees, there have been massive layoffs over the past three months. Unregistered and informal labourers who are estimated to constitute nearly 75 per cent of Pakistan's workforce have been particularly badly affected. Thus, as it confronts a health crisis, Pakistan also finds itself grappling with the impact of the pandemic on its GDP, export sector and current account deficit.

Pre-emptive Initiatives

On 26 February 2020, two students who had returned from Iran were reported as the first individuals to test positive for COVID-19 in Pakistan. The failure to ensure safe quarantine of Shia pilgrims returning from Iran further led to a spike in the number of imported cases. In the coming weeks, the number of locally transmitted cases started to increase and the federal and state governments began to enact measures to control the virus. For instance, the federal government refused to evacuate Pakistani students in Wuhan, China, due to concerns over importing more cases of the virus. On 21 March 2020, all international flights were suspended. While the federal government resisted declaring a complete shutdown preferring a targetted approach of shutting down specific institutions and services such as universities, various state governments imposed stricter lockdowns.

In anticipation of the impact of provincial shutdowns and the wider economic impact of COVID-19, the federal government announced a relief package of Rs1.13 trillion (S$9.08 billion). It promised relief to individuals like daily-wage earners who have been hit the hardest by lockdowns as well as industry. Particularly noteworthy is the fact that Rs200 billion (S$1.8 billion) was allocated for direct support to lower-income groups and some 5.2 million people who are registered as recipients of financial assistance under the Benazir Income Support Programme were given stipends of Rs3,000 (S$27) a month. In addition to this, Rs50 billion (S$420.8 million) was committed to providing essential food supplies at subsidised rates to those who were financially struggling as a result of the pandemic.[3]
For industry, the package included a deferment of interest payments and the slashing of sales tax. All banks, development finance institutions and non-bank finance companies were granted permission to defer repayments of principal loans for a year. Furthermore, the Central Bank's debt burden ratio for consumer loans was relaxed from 50 per cent to 60 per cent. The aim was to ensure that people could borrow more from banks in the time of crisis. The regulatory limit on credit to small and medium-sized enterprises (SMEs) was also increased from Rs125 million (S$1.05 million) to Rs180 million (S$1.5 million) to alleviate a potential credit crunch which could drastically affect SMEs.

With a view towards improving liquidity in the key sector of textile exports, Rs30 billion (S$252.5 million) was sanctioned to pay back duty drawbacks and customs duties that had been previously paid by textile exporters. Textiles constitute 60 per cent of Pakistan's exports and the textile sector contributes approximately nine per cent to the country's GDP. The textile industry also hires nearly 30 per cent of Pakistan's workforce. More broadly, the

[3] Imran Kundi, 'ECC approves Rs50 billion relief package', *The Nation*, 9 April 2020, https://nation.com.pk/09-Apr-2020/ecc-approves-rs50-billion-relief-package-for-subsidised-items-at-utility-stores. Assessed on 11 April 2020.

payback of duty drawbacks and customs duties is part of a wider initiative to urgently expedite the release of refunds on duties claimed by exporters.

A series of special incentives was also announced for the construction sector. Prime Minister Khan noted that the construction sector needed particular attention due to the large number of jobs it generated for daily wage workers. He announced the setting up of a Construction Industry Development Board to support the sector and that a subsidy of Rs30 billion (S$252.5 million) would be given to the government's Naya Pakistan housing project with the aim of generating construction and employment. Moreover, a series of tax reforms aimed at stimulating the construction sector was announced. These included the reduction of sales tax, scrapping of capital gains tax on the sale of houses and lifting of withholding tax on construction. Investors in the sector would also not be questioned about the sources of their investments.[4]

These initiatives notwithstanding, the government is confronted with the fact that the COVID-19 pandemic is worsening Pakistan's fiscal and trade deficit. On the one hand, there has been a fall in demand for Pakistani exports. On the other, there are concerns over revenue mobilisation from taxes at the provincial and federal levels. Pakistan's current account deficit is further being complicated by the increased expenditure on healthcare and welfare programmes necessitated by the spread of the disease.

Worsening Fiscal and Trade Deficit

Pakistan was amidst its 13th International Monetary Fund (IMF) bailout plan when the pandemic hit. A crippling current account deficit had pushed the country to approach the IMF for a loan in October 2018. At that point, Pakistan's foreign reserves could cover less than two months of its imports. Pakistan negotiated a US$6 billion (SG$$8.36 billion) bailout plan with the IMF which was to be implemented over the coming 39 months. On its part, Pakistan agreed to make structural reforms, correct 'structural imbalances' and impose austerity measures.[5] Specifically, Pakistan committed to paying back US$37.359 billion (S$52.08 billion) of its external debt over the duration of the programme and decreasing its external debt from 80.5 per cent of GDP to 67 per cent.

The conditionalities of the IMF bailout have been tough on Pakistan. For instance, Pakistan and the IMF agreed to maintain the budget deficit for the fiscal year 2019-2020 at 7.2 per cent of the GDP as opposed to 8.9 per cent in the previous year. To achieve this, Pakistan would have needed to drastically increase revenue mobilisation by four to five per cent of GDP both at the federal and the provincial levels.[6] The provinces were expected to contribute surpluses ranging from one per cent of the GDP in 2020 to 2.7 per cent of the GDP by the end of the programme. It was envisaged that the provinces would be able to raise these surpluses through increased collection of property and sales taxes, and adopting

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[4] 'Tax relief for construction sector, *KPMG Insights*, 1 May 2020. https://home.kpmg/us/en/home/insights/2020/05/tnf-pakistan-tax-relief-construction-sector.html. Assessed on 11 June 2020.

[5] *Request for an Extended Arrangement Under the Extended Fund Facility,* IMF Country Report No. 19/212 (July 2019). https://www.imf.org/en/Publications/CR/Issues/2019/07/08/Pakistan-Request-for-an-Extended-Arrangement-Under-the-Extended-Fund-Facility-Press-Release-47092. Assessed on 11 June 2020.

[6] Ibid, p 4.

more responsible spending.[7] At the same time, foreign reserves were to be bolstered from US$6.82 billion (S$$9.54 billion) to US$11.19 billion (S$15.60 billion) and stability was to be ensured by a market managed free floating exchange rate.

As painful as this path may have been, the Pakistan government, in line with the IMF recommendations, expected economic improvements. For instance, the government projected that tax revenues would increase by 12.8 per cent over the last fiscal year. This was calculated on the basis of an expected enormous increase in indirect taxes of about 40 per cent. Moreover, the provinces were expected to contribute 25.7 per cent more than in the previous fiscal year. Loans from Saudi Arabia and the United Arab Emirates had also increased the foreign reserves from US$14.48 billion (S$20.19 billion) in June 2019 to US$18.88 billion (S$26.32 billion) in February 2020.[8] Between July 2019 and February 2020, exports had also increased by 3.62 per cent and the trade deficit had showed signs of improvement. This would have resulted in reducing the pressure on the foreign exchange reserves. However, the pandemic has disrupted such projections and financial plans.

The pandemic has already resulted in the first annual contraction of Pakistan’s economy since 1952. The Economic Survey released by the Ministry of Finance reveals that Pakistan’s GDP contracted by 0.4 per cent in the current fiscal year. The ministry attributes this negative growth to “the unprecedented health and economic shocks caused by the outbreak of coronavirus.”[9] Data from April 2019 and April 2020 reveals that exports plummeted by 54.17 per cent since the onset of the pandemic.[10] The textile and leather industries have been hit particularly harshly with exports in these sectors declining by 64.52 per cent and 70.53 per cent respectively. It is worth noting that the textile industry itself accounts for nearly 55 per cent of Pakistan’s exports. It is estimated that cancellations or postponement of orders due to the pandemic have resulted in a loss of US$1.3 billion (S$1.81 billion). While the government has provided support to the textile industry in its relief package, the demand for Pakistani textiles has fallen drastically.

Successful fiscal consolidation was contingent on substantial increases in tax revenues, provincial contributions and limited government spending, all of which are now moving in the opposite direction. As discussed above, the government introduced welfare schemes to support individuals affected by the pandemic and implemented measures to support industries early into the pandemic. The cash transfers under the Ehsaas Programme and subsidies on food prices highlighted above will no doubt increase government spending and impact the budget deficit. At the same time, tax reliefs and incentives, and the deferment of payments afforded to various sectors of industry will also severely impact the government’s ability to raise revenue. It is worth noting here that the sales tax is an important means through which the provinces raise revenue. The reduction of sales tax – in line with the

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[7] Ibid, p 18.

[8] ‘Pakistan Foreign Exchange Reserves’. https://tradingeconomics.com/pakistan/foreign-exchange-reserves. Assessed on 15 June 2020.

[9] *Pakistan Economic Survey 2019-2020*, Finance Division, Government of Pakistan. http://www.finance.gov.pk/survey/chapter_20/PES_2019_20.pdf.

[10] ‘Statements Showing Exports of Selected Commodities’. http://www.pbs.gov.pk/sites/default/files//external_trade/monthly_external_trade/2020/May-2020/EXPORT-APR%2C2020.pdf. Assessed on 15 June 2020.

relief package offered to industry - and the need to spend more on health have placed immense strain on the budgets of the provinces.

Instead of meeting their financial contributions to the centre, it is likely that provinces will scale back provincial taxes, offer incentives to businesses and look to the federal government for further financial resources and aid. The budget passed by Punjab on 16 June 2020 for the fiscal year 2020-21 provides an important insight into the direction that the provinces will move in. The budget promises, among other things, significant relief in provincial taxes and, in some cases, tax exemptions to businesses affected by the pandemic and has earmarked Rs47 billion (S$395.6 million) for the Punjab Economic Stimulus Programme. The budget has also substantially increased the amount of money dedicated to health and welfare programmes.

Conclusion

The COVID-19 pandemic is likely to exacerbate Pakistan's debt crisis and leave the government with limited options to service its debt. As it is, the government had to take an additional loan of US$1.4 billion (S$1.95 billion) from the IMF and a loan of US$1.8 billion (S$$2.51 billion) from the Asian Development Bank and the World Bank to finance its relief package. The IMF has proposed a revenue target of Rs5.1 trillion (S$$42.9 billion) for the fiscal year 2020-2021.[11] This essentially signals an increase of 30 per cent from the previous year. Figures from the past reveal that revenue generally increases between 15 to 18 per cent. The budget for the coming fiscal year, which was presented by the federal government on 12 June, has closely conformed to IMF projections and targets. For instance, the government announced that tax revenue would be increased by approximately 27 per cent in the coming year. The government did not, however, explain how it planned to achieve this. Given the impact of the pandemic on Pakistan's economy and the global economic slowdown, it is highly unlikely that this target can be met. As the budget provides for no new taxes, it is difficult to gauge how this increase in revenue would be achieved. Furthermore, as discussed above, both the federal and provincial governments have provided tax-cuts and incentives to support businesses and help limit unemployment during the pandemic. It would be extremely difficult for the government to roll these back.

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[11] Irshad Ansari, 'IMF proposes Rs575 billion new taxes', *The Tribune*, 18 June 2020. https://tribune.com.pk/story/2223605/1-imf-proposes-rs575-billion-new-taxes-next-budget/?amp=1. Assessed 18 June 2020.

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