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Fiscal Policy Response to COVID-19 Pandemic: Case of Pakistan

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Context - Motivations

- **Pakistan amid COVID-19**
  - GDP growth plummeted to -0.5% during fiscal year 2019-20
  - Manufacturing sector hardest hit (-10%)
  - Public investment declined by 32% as spending was diverted towards pandemic related needs
  - Around 3 million jobs lost due to pandemic
  - Proportion of those living in poverty increased between 24% to 33%



Research project – questions and objectives

After comprehensive consultations with Planning Commission and Federal Board of Revenue, the team initiated the study on effectiveness of fiscal policy interventions as a response to pandemic. We were broadly concerned with the following **questions**:

- What were the macroeconomic and welfare impacts of changes in structure and rates of indirect taxes in federal and provincial budgets 2019-20?
- How have these changes provided relief to firms and households?
- How were changes in tariff policy designed and how far these measures rescued the firms in trade sector?
- What was the incidence of production subsidies? How far have these measures supported firms in the agriculture sector?



Methodology and Design of Experiments

- We use the PEP-1-t CGE model explained in Robichaud et al. (2016). We stick to the standard specification provided in the model documentation for ease of interpretation.

Policy experiments are based on actual changes in tax code:

- Simulation-I: A reduction in sales tax by 3.5% for activities under large scale manufacturing
- Simulation-II: Reduction in tariffs by 2% on priority agriculture and food items
- Simulation-III: Sales tax on select services reduced by 3%
- Simulation-IV: Production subsidy allowed to cotton sector



Data

- The CGE model presented here uses the Social Accounting Matrix (SAM) from the year 2014.

- The COVID-19 impact has been constructed by considering the following main transmission channels:

- Fall in employment level
- Rise in wages due to lower availability of labour amid lockdowns
- Lower labour also results in lower demand for capital, as both inputs are combined
- The international trade cost of both exports and imports is increased
- Demand for select services falls (e.g. transport).

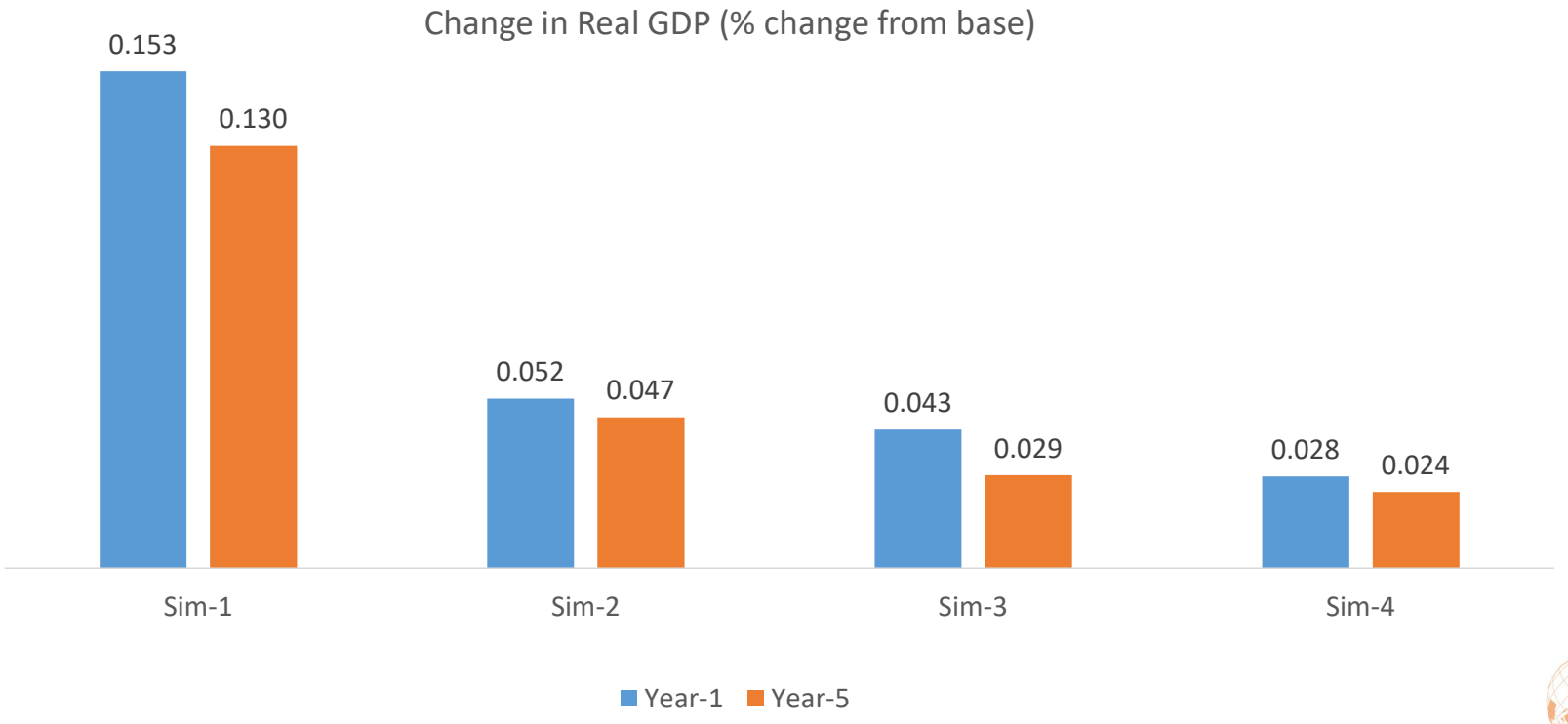


Baseline scenario here shows actual impact of COVID-19

Sr.no.	Indicators	Pre-Covid	Covid Impact (FY20) [Baseline]	Difference (PKR-local currency, bn.)
1	Real GDP (PKR billion; CBP)	10217	10176	-41
2	Fixed Investment (PKR billion; CBP)	1366	1362	-4
3	Household Consumption (PKR billion; CBP)	8305	8272	-33
4	Total Exports (PKR billion; CBP)	1225	1214	-11
5	Manufactured Exports (PKR billion; market prices)	1029	1021	-8
6	Total Imports (PKR billion; CBP)	1558	1549	-9
7	Government Revenues (PKR billion)	3637	3603	-34
8	Total indirect tax collection (PKR billion)	1480	1468	-12
9	Government Expenditure (PKR billion)	5026	5021	-5
10	Total Subsidies (PKR billion)	340	343	3

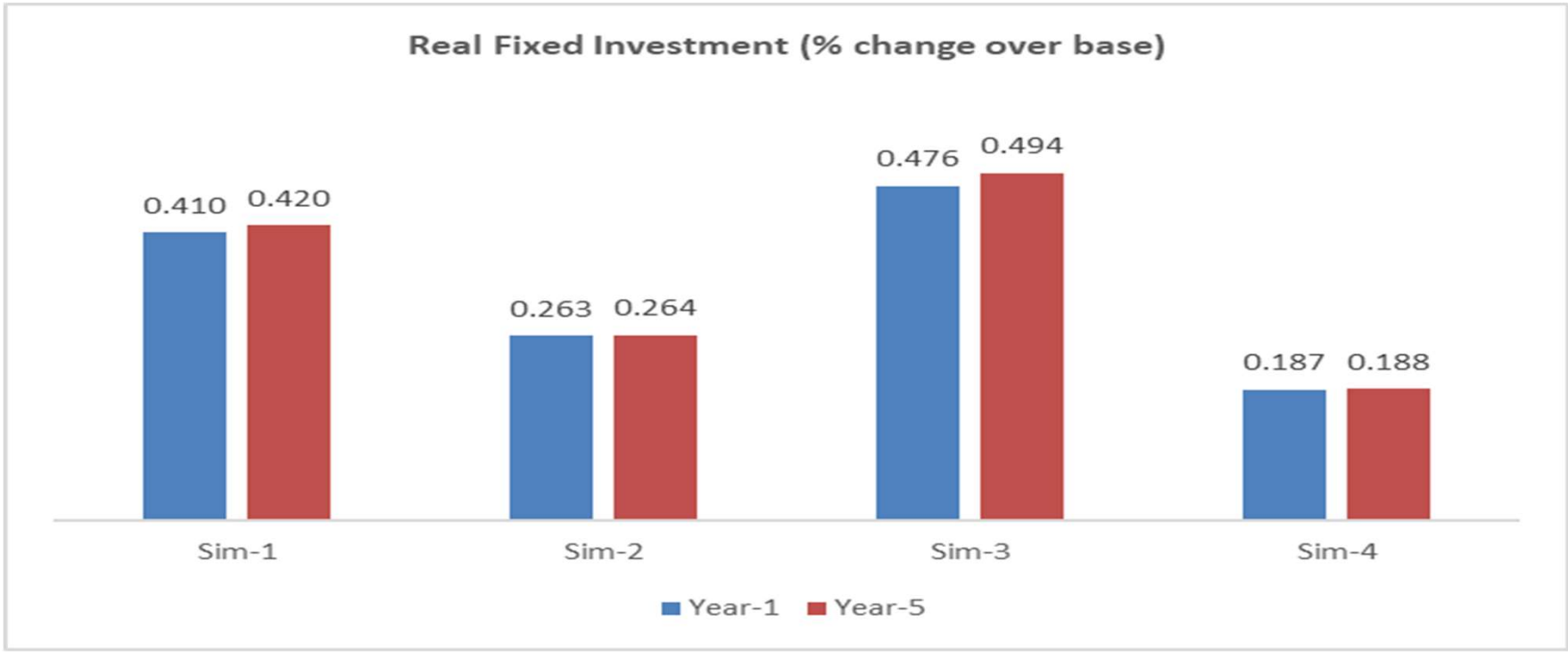
Findings

Growth impacts of policy measures



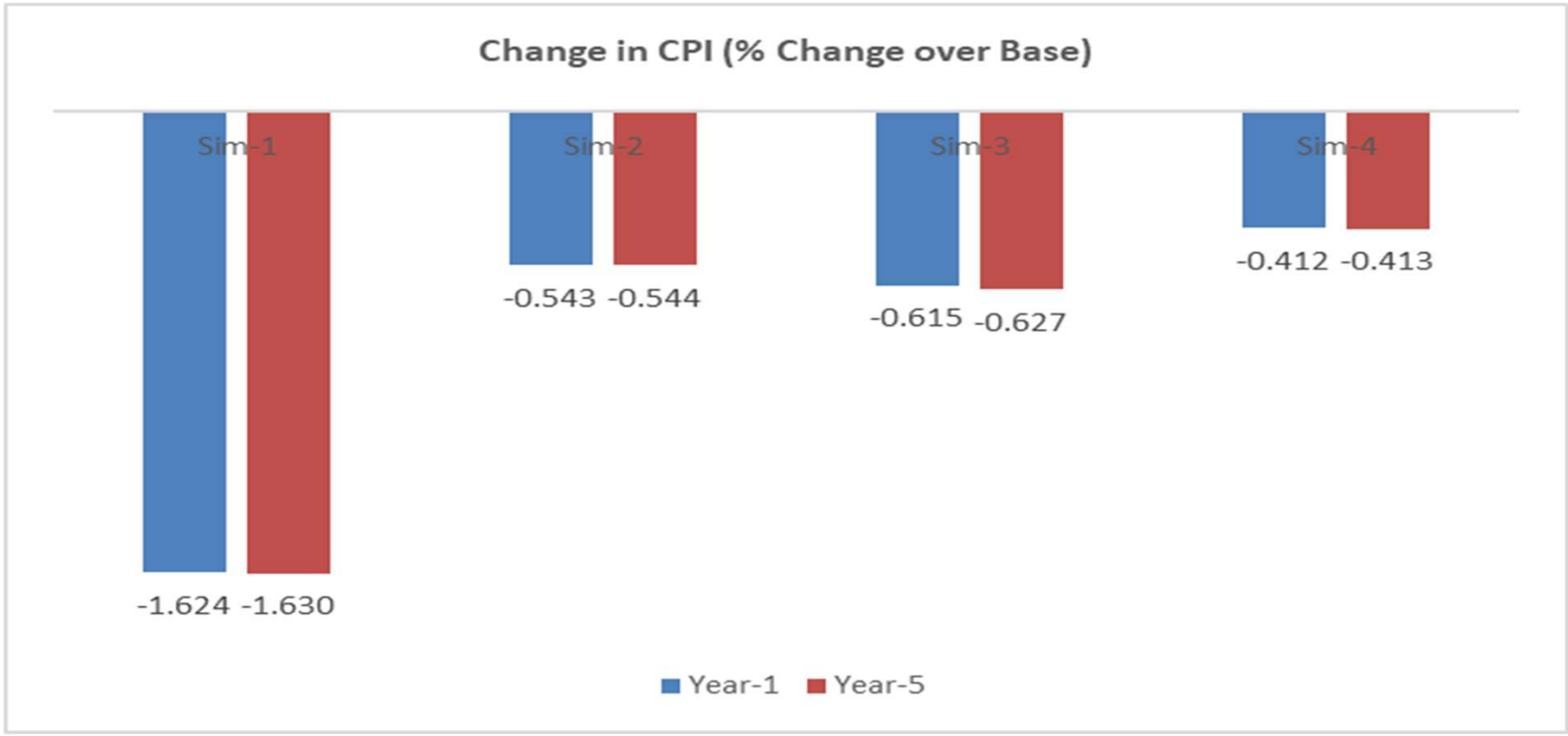
Findings

Investment impacts of policy measures



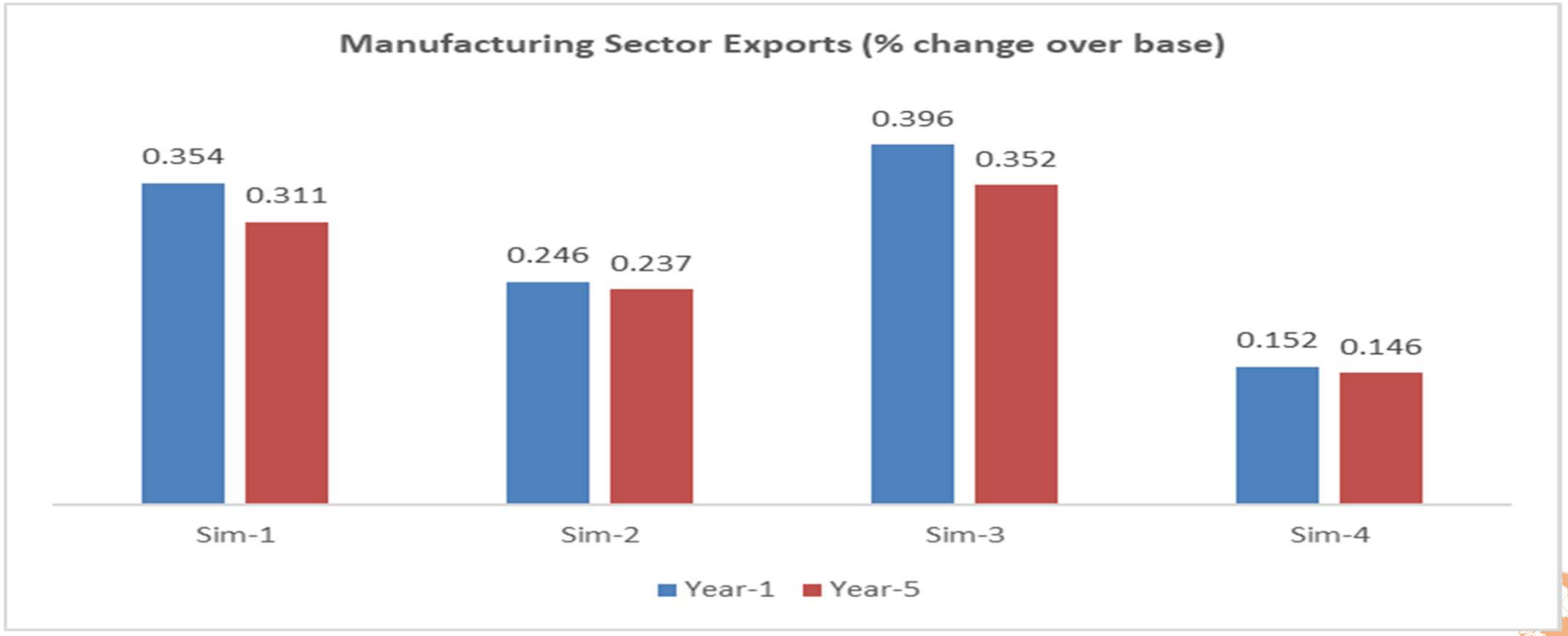
Findings

Impact on Prices



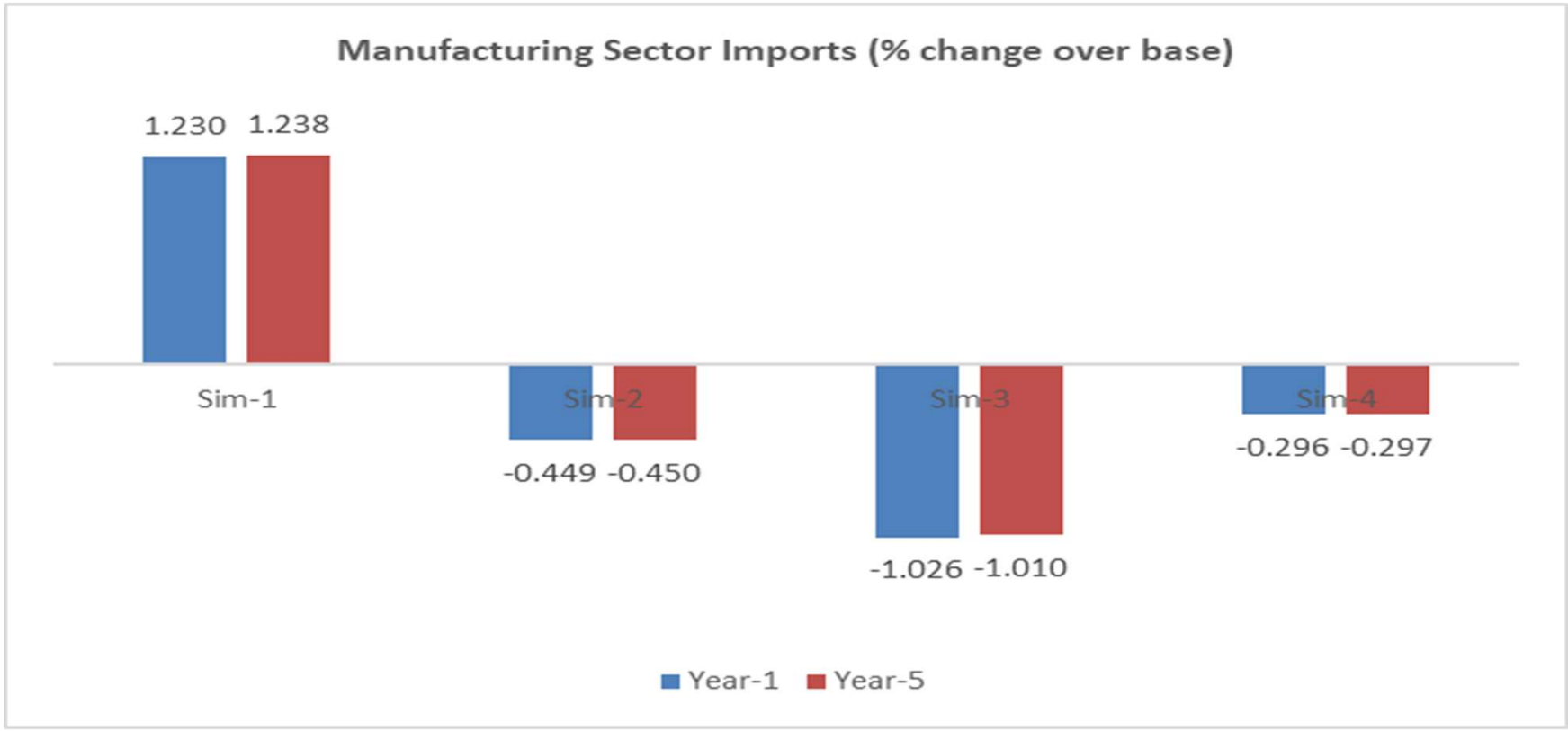
Findings

Impact on Trade



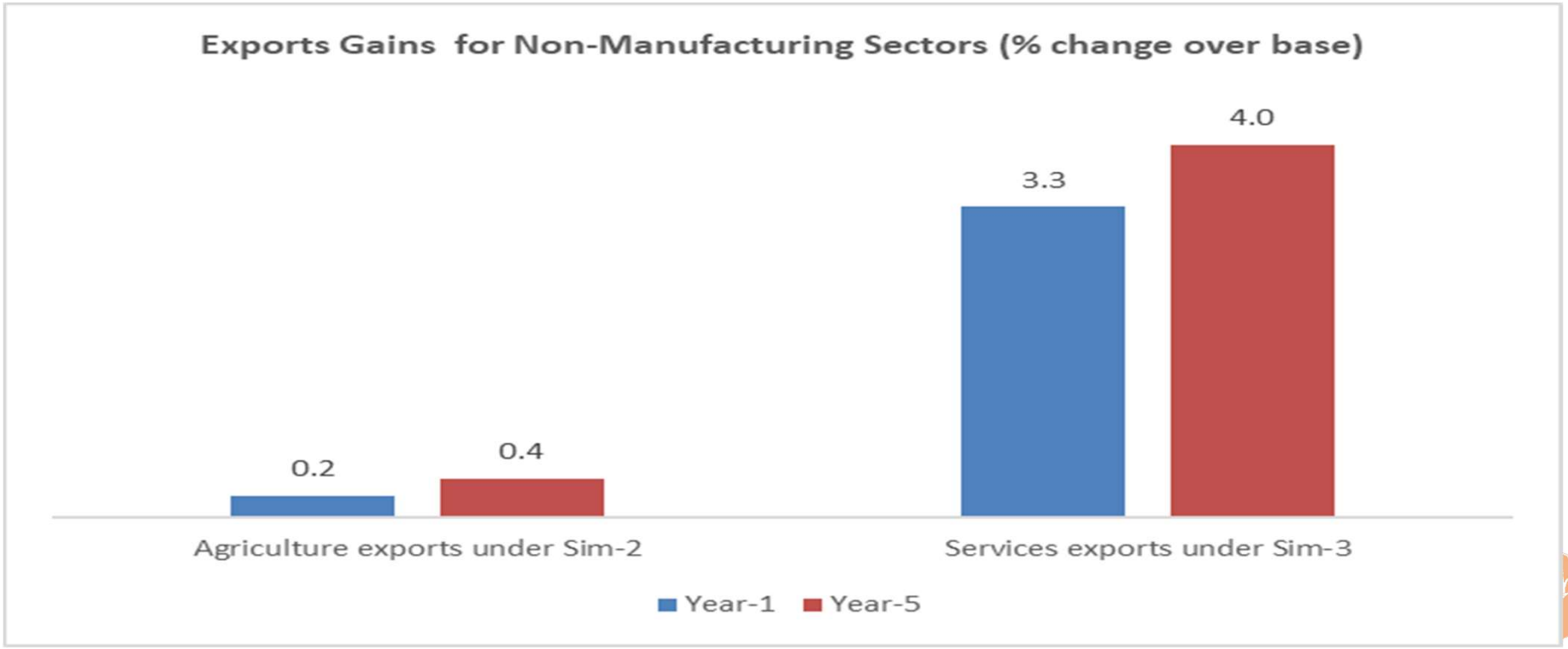
Findings

Impact on Trade



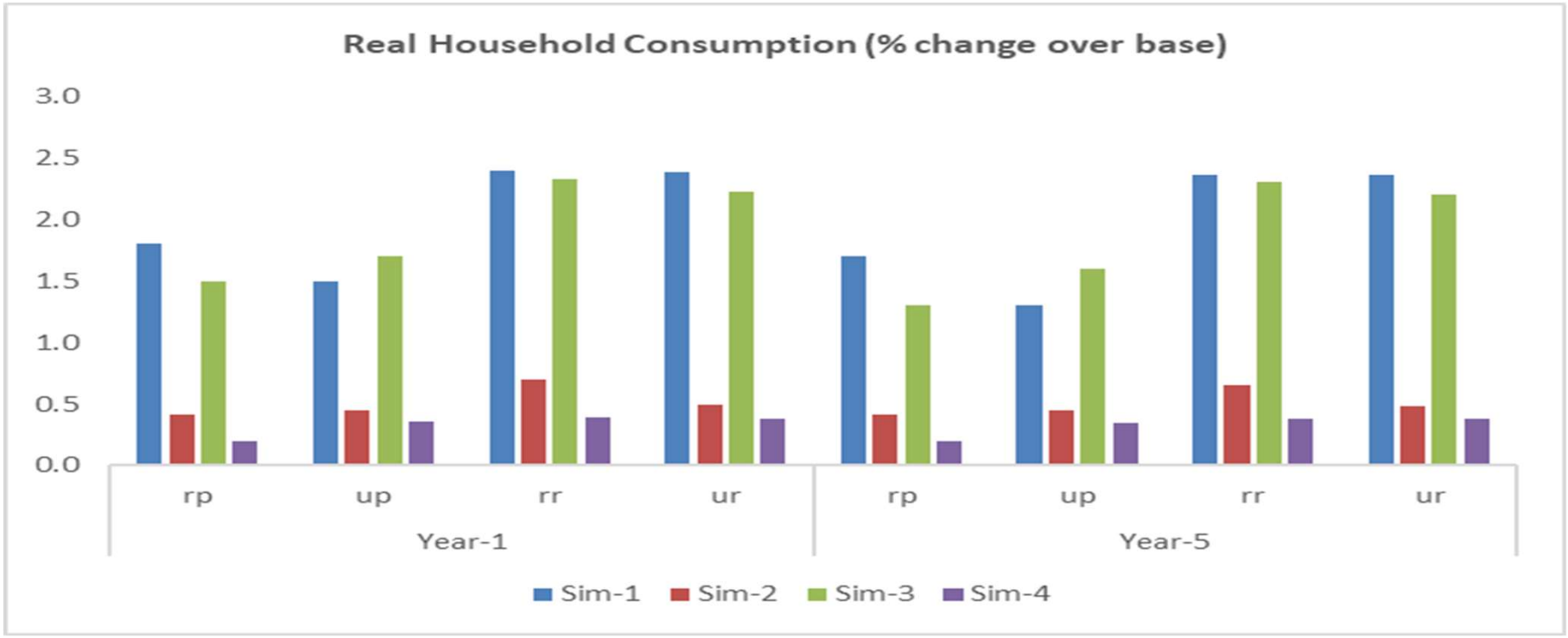
Findings

Impact on Trade



Findings

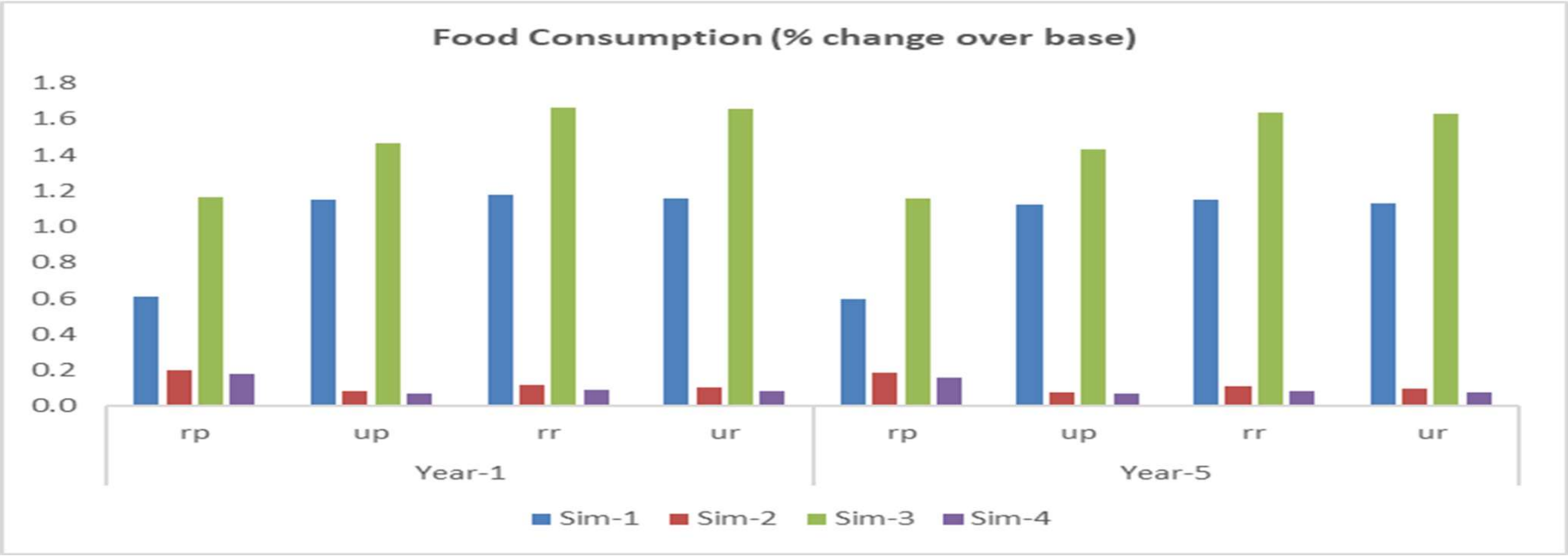
Impact on household consumption



rp=rural poor, up=urban poor, rr=rural rich, ur=urban rich

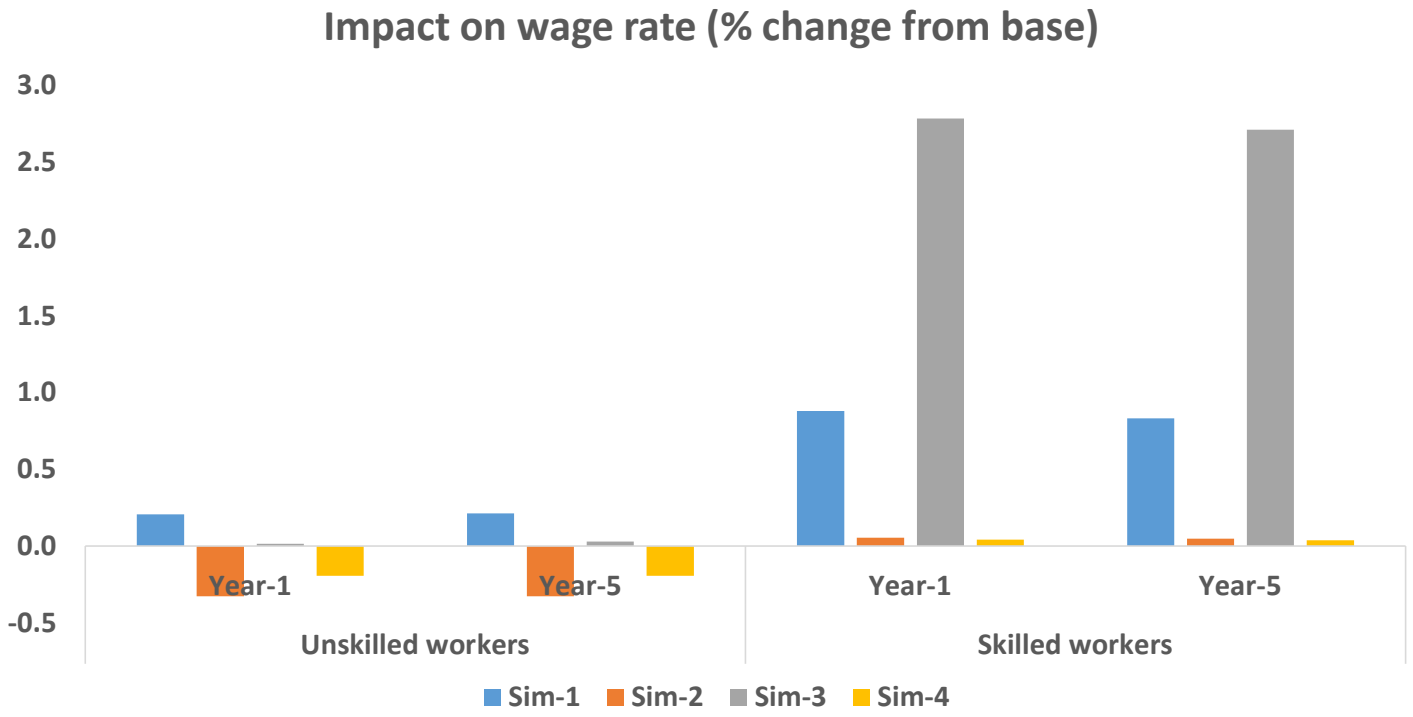
Findings

Impact on Food Consumption



rp=rural poor, up=urban poor, rr=rural rich, ur=urban rich

Findings


Impact on wage rate (% change from base)
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
Year-1
Year-5
Year-1
Year-5
Unskilled workers
Skilled workers
Sim-1
Sim-2
Sim-3
Sim-4

Findings

Impact on gender inequalities

- We are mindful that due to data limitations we could not provide analysis based on a gender-aware CGE model. Therefore, in consultation with Pakistan Bureau of Statistics we will include a section in our report on data requirements which could enable a gender-aware CGE analysis for Pakistan in future.

- However, we do have some findings on this subject from our qualitative analysis and interviews with women-led enterprises in Pakistan.

- Our discussions with World Bank Pakistan Office in June 2020 reveal how women-owned firms, which are usually smaller than firms owned by men, are **8 percent more likely to lose their entire revenue during the pandemic**. In the microenterprise sector, the uncertainty was much higher. The informal jobs, which account for most of women's employment in the microenterprise sector may have been adversely hit the most. Those women informal workers who are based at home may have lost their source of income completely. In terms of formal wage employment over a quarter of Pakistani women were laid-off or temporarily let-go from their jobs in various sectors including manufacturing industries and services.



Policy Implications

1. There is a clear need to study the potential of all federal and provincial-level taxes and what role these taxes could play in emergency times. Additional simulation exercises in future studies are required to understand if cut in compliance cost of taxes may lead to favourable gains.

2. Given that we see some inequality enhancing impacts of tax policy, therefore a future exercise could offer insights in to what supplementary expenditures or social protection related measures could be expanded to compensate for increase in inequalities.

3. Tax policy changes amid COVID-19 haven't resulted in a significant export gain for the agriculture and food sector. This needs to be explored further as this sector was able to see rise in availability of imported inputs even during the pandemic. Additionally, local inputs were also subsidized.



Conclusions

- **Three important takeaways**
  - First, out of all fiscal policy changes, those designed **for manufacturing sector offer highest gains** in real economic growth and reduction in consumer prices.
  - Second, **relief for services sector firms is equally important** as given its largest share in GDP fixed investment gains are highest once activities in this sector receive tax rate reduction.
  - Third, while all fiscal responses led to increases in trade gains including recovery in exports, however the **impact on net exports or terms of trade could differ** depending on several factors identified in this study – an area which we look forward to discussing further during our upcoming consultation with Federal Board of Revenue.



Thank you !

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