

Fiscal Risk Statement

This statement is prepared to comply with Section 4, Sub-Section 3 (b) of Public Finance Management Act, 2019, which states that Annual Budget Statement shall also contain statement of fiscal risks.

Fiscal risks are risks that may lead to deviations in fiscal forecasts presented in Medium-Term Budgetary Statement laid under section 5 of Fiscal Responsibility and Debt Limitations Act 2005. Principle of 'reasonableness' is followed which means that only those fiscal risks are presented that have a reasonable chance of materialising in the Budget Year 2020-21 and the medium-term.

Economic risks: Corona has had profound impact on Pakistan's economy. For the first time in many decades, Pakistan's economy has entered into recession as GDP contracted by 0.4% in 2019-20. As per the current estimates, economic growth is projected at 2.1 percent in 2020-21. However, there are downward risks to target growth emanating from two uncertainties: 1) worsening global economic situation, and 2) prolonged recovery in domestic markets. If these risks materialise, then tax revenue collection target is likely to be impacted. However, these risks are categorised as short-term risks predominantly affecting 2020-21 forecasts. The medium-term outlook remains positive and economic growth is projected to see sustained recovery.

Losses in energy sector: While the government has taken a number of steps to reduce energy sector losses, including increase in prices of energy for high-end consumers, improved management, and resolution of circular debt, there are high off-budget arrears and liabilities. There are two main risks emanating from; 1) non-reduction of flow of energy sector losses, and 2) non-payment of arrears and liabilities. Both of these risks may impact government's fiscal position if such arrears and liabilities are required to be paid through the budget.

Losses in Public Sector Enterprises (PSEs): The government provides guarantees, grants, loans and at times equity investments to Public Sector Enterprises. Guarantees are categorized as contingent liabilities, however, the grants, loans and equity investments directly impact the budget as they increase the Government's expenditure. While the government intends to structurally reform PSEs there is a risk that such reforms take more time than envisaged which will negatively impact government finances. To mitigate these risks, the Government is committed to develop a new State-Owned Enterprise Law in the latter half of 2020 that will provide a stronger governance and performance management framework.

The government also intends to adopt a clear policy for establishing PSEs in future, deciding whether to sell, liquidate or retain the existing PSEs. The policy will decide as to which of the PSEs shall be retained or established in future or shall be run on a self-sustainable basis. Similarly the policy will also lay down principles regarding giving subsidies to the SOEs on an ongoing basis.

Natural disasters: Historically, natural disasters included floods, earthquakes, droughts etc. Since 2005, damages and losses resulting from natural disasters in Pakistan have exceeded USD 18 billion¹. Government has established disaster management functions in shape of disaster management authorities, created a fund (called National Disaster and Risk Management Fund) and formulated various policies, strategies and plans (e.g. National Disaster Management Plan 2013-2022). In addition, the government has also allocated on-budget natural disaster and contingency reserve to deal with natural disasters in 2020-21 budget. However, there is a risk that natural disaster will have negative impact on the medium-term fiscal position.

Budget surpluses of provinces: The need to project/expect large provincial budget surpluses in future points to a broader problem with the fiscal landscape of the country. With the provinces taking a substantial share of national revenues, and federal government being liable for almost the entire national debt, the structural fiscal balance has become lopsided. The situation is unsustainable unless an appropriate adjustment occurs in the structural fiscal balances of federal and provincial governments. The government has formed 10th National Finance Commission with the view to deliberate on options leading to fiscal harmonisation.

Conclusion: In order to mitigate these risks, continued monitoring and implementation of structural reforms agenda shall be pursued. Reduction of fiscal deficit to make Pakistan's debts more sustainable and identification of fiscal space for priority human and infrastructure development will remain the key principles based on which medium-term fiscal policy shall be based.

¹ World Bank Estimates: Report No. 94474-PK "Fiscal Disaster Risk Assessment Options for Consideration, PAKISTAN"