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IPR's Review of the Advertisement by the Ministry of Finance, Government of Pakistan on

'ONE YEAR OF ECONOMIC TURN AROUND'

ABOUT IPR

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4- Shami Road,
Lahore Cantt,
Pakistan. UAN: 111-123-586
www. ipr.org.pk

WORKING GROUP

Lead: Dr. Hafiz A. Pasha, Managing Director IPR, Former Finance Minister

Members:

1. Mr. Humayun Akhtar Khan, Chairman IPR, Former Commerce Minister
2. Mr. Haroon Akhtar Khan, Director IPR, Former Senator
3. Mr. Abdullah Yusuf, Advisor IPR, Former Secretary Gen. Revenue Division

Research Support:

1. Ms. Mehwish Gull, Research Associate
2. Mr. Nabeel Abbas

Executive Summary

The PML (N) government has recently put out an advertisement in the news media highlighting the 'One Year of Economic Turnaround' with 'facts that speak for themselves'. The major achievements in 2013-14 are listed and a comparison made of some economic growth indicators for 2013-14 with 2012-13. IPR has reviewed the stated achievements and indicators.

There are indeed some major achievements by Government. First, of great importance is that the external payments position has been stabilized and the rupee has appreciated significantly since March 2014. Foreign exchange reserves have shown growth of over 50% in one year. However, it needs to be emphasized that this improvement has occurred on the back primarily of large one-off inflows. Net external borrowings in 2013-14 are $6.3 billion, the highest in the last four years. By the end of the year, external debt has crossed $66 billion, over 25% of the GDP.

Other achievements include, first, the successful 3G auction which had been pending for some years. Second, the Benazir Income Support Program has been expanded in coverage and the monthly stipend increased by 50%. This demonstrates due concern of the Government for the plight of the poor, in a period of rising food prices and unemployment.

Other successes are more qualified in nature. First, two major hydel projects (Dasu and Diamer-Basha dam) have been initiated. Some initial funding has been committed for Dasu by the World Bank but it is not clear how the large combined cost of over $13 billion will be financed. The resumption of program assistance by the multilateral agencies is a reflection of the comfort provided by the presence of an IMF program and completion successfully of three quarterly reviews.

Second, there has been success in selling Eurobonds of $2 billion, but at a high cost. Third, remittances have shown growth of almost 14%, but this is only a continuation of the trend 17% growth since 2007-08. Fourth, the KSE index and market capitalization have shown high growth in 2013-14.

This is also not a new phenomenon. In 2012-13, the KSE index showed even faster growth of 53%, as compared to 41% in 2013-14. Fifth, the big increase in credit to the private sector is not reflected in the level of private investment, which fell to its lowest level ever and by as much as 27% in the manufacturing sector.

Then there are successes highlighted of a disputed nature. The biggest controversy surrounds the government's claim that GDP growth rate in 2013-14 was the highest in six years, at 4.1%. This is considered as the prime indicator of the economic turnaround. IPR estimates the growth rate at 3.5%, while the IMF believes that it is 3.3%. These latter growth rates imply that the GDP growth in 2013-14 is actually the lowest in the last four years.

The other area relates to developments in international trade of Pakistan. Based on PBS data, the Government claims that the growth rate of exports (at 3%) is higher than that of imports (at below 1%) in 2013-14 and, consequently, the balance of trade has improved by 3%. But the story is entirely different if the more relevant SBP database is used. The balance of trade has deteriorated by 8%, due to slower growth in exports (1%) than imports (4%) in 2013-14.

A similar problem arises with regard to the size of the budget deficit. The Government reports a major improvement in the deficit from 8.2% of the GDP in 2012-13 to 5.7% in 2013-14. This is based on a combined surplus of the provincial governments of almost 0.7% of the GDP, but the provincial budget documents report this as less than 0.2% of the GDP. Further, pending liabilities of over Rs.300 billion of circular debt in the power sector has not been taken care of in 2013-14.

The advertisement also claims that FBR has achieved its revenue target. But despite two major downward revisions, there has been a shortfall. The growth rate of over 16% compares favorably, no doubt, with the only 3% growth in 2012-13, but this was an election year and many tax reliefs were given. FBR revenues showed faster growth in 2011-12 and 2010-11 of 17% and 23% respectively.

The publication of the tax directory by FBR must be appreciated as a major step forward in terms of greater transparency. But it reveals worrying trend. First, that the number of individual tax payers has actually declined over the last six years. Second, only 35% of the companies registered with the SECP have filed returns and, third, over 41% of the tax payers have made zero tax payment.

There are also some, what may be considered, 'tall 'claims. Mr. Jim O Neill of Goldman Sachs is quoted as forecasting that Pakistan would be the world's 18th largest economy by 2050, which is currently Australia. This will require sustained high growth rate of the GDP in US dollars of over 9% annually by Pakistan to catch up with Australia in the next 36 years.

The good news is that Moody's has improved Pakistan's existing rating of Caa1 from 'negative' to 'stable'. But the reality is that Pakistan has the lowest rating in South Asia. Other indicators in which Pakistan does not do too well is the Global Competitiveness Index of the World Economic Forum, in which its ranking has fallen to 133rd as compared to 124th in 2012-13. Similarly, in the World Bank's Cost of Doing Business, Pakistan has fallen from 107th to 110th position. In the Human Development Index of UNDP, even Bangladesh has gone ahead.

The Government has accepted that the inflation rate was higher at 8.6% in 2013-14 than 7.4% in 2012-13. Actually, the difference is even larger(at almost four percentage points) in the Sensitive Price Index (consisting of essential items) is considered, because of substantially higher inflation in many food items like pulses and vegetables.

The Government is raising the size of the PSDP, as it moves towards implementation of mega projects. At this time highest priority and allocations should be given to power and water sector projects. But in the PSDP of 2014-15 the largest allocation has been given to highways of Rs.112 billion, over one fifth of the total PSDP.

With regards to privatization, the Government has highlighted the sale of UBL and PPL shares, which has been facilitated by the attractiveness of the two shares and a buoyant stock market. The real challenge is restructuring and privatization of loss making public sector enterprises, which are a heavy drain on the exchequer.

In summary, IPR believes that there have been some significant achievements in the first year by the PML(N) government, especially in stabilizing the economy. But a strong and sustainable ‘economic turnaround’ remains elusive in the presence of slow agricultural growth, recent loss of momentum in manufacturing, fall in investment and saving rates, severe energy shortages, stagnating exports, low tax-to-GDP ratio and a rising external debt burden. We hope that the economy will show major improvement in years to come.

The Ministry of Finance, Government of Pakistan, has advertised recently in leading newspapers the good economic performance of the PML (N) government, under the following caption:

'One Year of Economic Turnaround : Facts speak for themselves'

IPR has reviewed claims of improvement in key economic indicators in 2013-14, as compared to 2012-13.The findings are presented below.

I. Major Achievements

- **Achieved GDP growth of over 4 %(4.14%) for the first time in 6 years.**

IPR estimates that at the maximum the GDP growth rate in 2013-14 is significantly lower at 3.5%, while the IMF reports it at 3.3%. The growth in large-scale manufacturing, construction, banking and insurance and wholesale and retail trade has been overstated. A GDP growth rate of 3.3% to 3.5% makes it the lowest in the last four years.

- **Foreign Exchange Reserves: After payments of previous loans, reserves dropped to US$ 7.57 billion(of which SBP US$ 2.82 billion) on 10th Feb, 2014; reserves increased to US$ 14.11 billion(of which SBP US$ 9.09 billion) on 30th June 2014 and US$ 14.3 billion (of which SBP US$ 9.3 billion) on 4th August 2014**.

Reserves dropped to US $ 2.82 billion by 10th Feb 2014 not only due to repayment of loans. About 60% was due to a large current account deficit and the remainder, 40%, mostly because of net repayment of loans.

The subsequent increase upto 4th August 2014 is due to a gift from a friendly country, flotation of $2 billion of eurobonds, enhanced programme assistance from multilateral institutions and privatization receipts. In fact according to IMF, the net external borrowing was $6.3 billion in 2013-14, the highest in the last five years. External debt has exceeded $66 billion by end-June 2014.

- **Allocation for the less privileged from Rs.40 billion to Rs.118 billion. Monthly stipend increased from Rs.1000/- to Rs.1500/- while the number of beneficiaries increased from 4.1 million to 4.8 million and will be raised to 5.3 million**.

The Government has done well in, first, preserving the name of the Benazir Income Support Program (BISP), second, in increasing the monthly stipend by 50% and, third, by expanding the coverage. This demonstrates the concern of the Government about rising poverty in the country at a time of rising food prices and unemployment . However, the seven new schemes launched in the Budget of 2014-15 encroach on the provincial domain. As per the 18th Amendment, 'social welfare' has been transferred to the provinces.

- **Stable Pak Rupee**

This must be recognized as one of the major achievements of the Government. The rupee appreciated sharply in March 2014, following the receipt of the gift of $1.5 billion. But there is some concern that this was 'too much, too soon'. Also, the rate of inflation has not declined significantly after the major appreciation of the rupee.

- **Initiated Hydropower Projects: Secured international funding for Dasu Hydropower Project and land acquisition for Diamer Bhasha Dam in progress.**

This must also be acknowledged as an achievement by the Government in its efforts to reduce the long-term cost of power generation. The World Bank has committed $700 million, but the combined cost is $13800 million. The question is how the remaining cost of over $13 billion will be financed given the limited fiscal space available for such large mega development projects.

- **Development expenditure under PSDP increased from Rs.360 billion to Rs.441 billion and is now budgeted at Rs.525 billion**.

The Planning Commission indicates that upto the last working day(27th) of June the total releases under the PSDP were Rs.400 billion, not Rs.440 billion. The issue is also one of priorities. In 2013-14, Rs.23655 million have been released for the Rawalpindi-Islamabad Metro Bus Project. This project was not even in the original PSDP. The required funds have been diverted from the Water Sector. This should not have been done as Pakistan is well on the way to becoming a 'water scarce' country, as highlighted in Vision 2025.

The other concern is that the largest allocation proposed in the PSDP of 2014-15 is to the National Highways Authority of Rs.111.6 billion, as compared to allocation to the Water and Power sectors of Rs.43.4 billion and Rs.63.6 billion respectively. At this time, the highest priority should have been given to the latter two sectors.

- **Elimination of Discretionary Grants**

This is a welcome departure from the practice of the previous PPP Government, which reached a peak in the election year of 2012-13. But a new practice which has emerged is the circumvention of the planning process by large allocation to 'unapproved' mega projects in the PSDP of 2014-15. Proper PC1s (project feasibility document) ought to have been prepared for these projects and submitted to CDWP/ECNEC for approval.

The radio spectrum license of 3G and 4G has been successfully auctioned. The target of Rs.120 billion receipt achieved as against the target of Rs.79 billion set previous government.

- This had been pending for a number of years and Pakistan had fallen behind in the telecom sector. The Ministry of Information Technology and Telecommunications deserves special commendation for completing the auction process successfully.

- **Successfully tapped international capital markets after a gap of 7 years by issuing Eurobonds worth US$ 2 billion.**

  This is, of course, a reflection of larger global liquidity and greater confidence in Pakistan in the presence of an IMF program and completion successfully of three quarterly reviews. But the concern is relatively high cost of the Eurobonds, which is even higher than that of bonds floated by Greece, the 'basket case' of Europe.

- **For the first time ever published a Parliamentarians' Tax Directory as well as a General Tax Directory. Pakistan is only the fourth country in the world to do so.**

The Federal Board of Revenue (FBR) has greatly enhanced transparency by publishing the Tax Directory. But the findings from the Directory are revealing and very worrying. The total number of tax payers is 791,033 only out of which as many as 328,841 (41.57%) filed zero returns. The number of individual tax payers has declined in the last six years.

- **FBR achieved is revenue collection target besides increasing the number of taxpayers by 100,000.**

In the Budget of 2013-14, the original revenue target was set at Rs.2475 billion. Following discussions with the IMF, a more realistic target of Rs.2345 billion was fixed. In the last quarter, this target was reduced even further to Rs.2275 billion. There has been a shortfall even in the attainment of the latest target.

The FBR drive to serve notices to NTN holders who do not file returns has been an abysmal failure. Only a few thousand persons have responded. It is highly unlikely that the number of taxpayers has increased by 100,000.

- **Government successfully completed divestment of shares in UBL and PPL.**

This is not surprising, given the buoyancy of the stock market and the attractiveness of the two shares. But the real challenge for the Government is to restructure and privatize loss-making public sector enterprises(PSEs), which are a big drain on the exchequer.

- **After a long interval multilateral donors like World Bank and Asian Development Bank resume normal business with Pakistan.**

This is primarily due to the comfort provided by presence of the IMF program and the successful completion of the first three reviews. But continuation will hinge on fulfillment of conditionalities attached to the budget support.

- **International think tanks and research groups like JETRO(declared Pakistan second in terms of business growth), Goldman Sach's Jim O'Neill(forecast that Pakistan would be world's 18th largest economy by 2050), OICCI(raised index from -34 to +2), Moody's (raised outlook from negative to stable) and Nielsen's Global Survey of Consumer Confidence(rose to 99 in the 1st quarter of 2014 from the lowest level of 86 in 3rd quarter of 2011) have recognized Pakistan's impressive economic turnaround.**

Pakistan is today ranked as the 27th largest country in terms of the size of the GDP (in current US$). The 18th ranked country is Australia, which has a GDP currently 88.7% larger than Pakistan. If Pakistan is to catch up with Australia by 2050, its GDP in US $ has to grow annually at 9.5% over the next 36 years. This is highly improbable.

Moody's has improved Pakistan's rating from negative to stable. But Pakistan has a very low rating of Caa1, which is worse than that of Bangladesh (Ba3), Sri Lanka (B1) and India (Baa3).

Other major international sets of indicators indicate that Pakistan's ranking has worsened in 2013-14. In the **Global Competitiveness Index** of the World Economic Forum, Pakistan's ranking has fallen from 124th in 2012-13 to 133rd in 2013-14. Similarly, in the World Bank's **Cost of Doing Business Index**, Pakistan has fallen from 107th to 110th position.

The 2013 Human Development Index of UNDP reveals that Pakistan has remained at 146, with low human development. Meanwhile, even Bangladesh has gone ahead of Pakistan.

II. ECONOMIC GROWTH INDICATORS

- **Large - Scale Manufacturing Sector Growth Increases from 3.9% to 4.2%**

The growth rate in the last four months, February to May, has come down sharply to 1.37% as compared to 5.95% in the first seven months. The growth has also not been broad-based. The fertilizer sector has shown the highest growth rate of 17.67%, due to the diversion of natural gas to it from the power sector. This policy has implied an increase in the overall import bill of $ 400 billion.

- **FBR Revenue has increased by 16.44% from Rs 1946 billion to Rs 2266 billion**

The 2013-14 Budget contained a heavy dose of taxation proposals, including the regressive move of enhancing the standard GST rate from 16% to 17%. A comparison is frequently made with the growth rate of only 3% in 2012-13. The Budget of 2012-13 was an election year budget, with a lot of tax relief.

The growth rate of 16.44% in 2013-14 of FBR revenues compares somewhat unfavorably with the growth rates achieved earlier in 2010-11 and 2011-12 of 16.78% and 22.98% respectively in FBR revenues.

- **Remittances have increased by 13.7% from US $ 13.93 billion to $ 15.83 billion**

This is indeed a silver lining to the economy and helped greatly in keeping the current account deficit at relatively low level. But the growth rate of 13.7% is less than the trend growth of remittances between 2007-08 and 2012-13 of 16.6%.

- **Exports have increased by 2.73% from US $ 24.46 billion to US $ 25.13 billion**

This is based on PBS data. The more relevant data is from the SBP on cash export receipts. This shows a growth rate of only 1.46%. Also, since the appreciation of the rupee in March 2014, exports have declined by 1.55% in the last quarter of 2013-14, indicating some loss of competitiveness. Further, exports have become more concentrated in exports of rice and textiles. Emerging exports have fallen by 6.75%.

- **Import growth has been contained at 0.35%, with imports at $ 45.11 billion in 2013-14 as compared to US $44.95 billion in 2012-13**

Here again, the use of SBP data reveals a somewhat different picture. According to this source, the growth rate is higher at 3.87%. In fact, imports have grown faster than exports in 2013-14, contrary to the conclusions from PBS data.

- **Trade Deficit is smaller by 2.55% in 2013-14 at $ 19.98 billion as compared to US $ 20.49 billion in 2012-13**

Use of SBP data reveals that the trade deficit has not decreased, but actually increased by 7.73%. In fact, the overall current account deficit has risen by as much as 17.19% in 2013-14.

- **There has been a big reduction in the budget deficit by 2.5% of the GDP, from 8.2% in 2012-13 to 5.7% of the GDP in 2012-13**

The budget deficit is estimated for 2013-14 on the basis of a combined surplus of the four provincial governments of 0.7% of the GDP. But according to the revised estimates for 2013-14 in the Provincial Budget documents for 2014-15, the combined surplus is less than 0.2% of the GDP. Therefore, the consolidated fiscal deficit is higher. Also, the liabilities of circular debt of Rs 300 billion have not been cleared in 2013-14.

The Ministry of Finance indicates that the public debt to GDP ratio stands at 62.0% of the GDP in 2013-14. With the higher deficit mentioned above it is 62.5% of the GDP, almost the same as the level of 62.7% in 2012-13. Therefore, the ceiling imposed on the public debt to GDP ratio of 60% in the **Fiscal Responsibility and Debt Limitation Act** continues to be violated.

- **Inflation is 8.6% in 2013-14 as compared to 7.4% in 2012-13**

The Ministry of Finance acknowledges that the rate of inflation (as measured by the Consumer Price Index) has gone up in 2013-14. In fact, the difference in the Sensitive Price Index (consisting of essential items in the consumer basket) is even more pronounced. It is 10% in 2013-14, compared to 6.1% in 2012-13. For example, the price of one item, potato has gone up by as much as 140.1% in 2013-14.This alone accounts for almost 25% of the increase in the cost of living for the lowest income group.

The government argues that the higher inflation is due to the big increase in the price of electricity, which had been deferred by the PPP government due to the elections. But oil prices have risen much less in 2013-14 and the sharp appreciation of the rupee should have helped in containing inflation.

- **The number of new companies incorporated has increased by 16.03% from 3953 in 2012-13 to 4587 in 2013-14**

This is good news and indicates the likelihood of more private investment down the road. But, according to the Pakistan Economic Survey of 2013-14, there has actually been a decline in the number of listed companies in the Karachi Stock Exchange from 569 in 2012-13 to 559 in 2013-14 and only four new companies have been listed. Also, a source of concern is that while there are close to 68000 companies in Pakistan today, only 25350, or 37.27%, filed returns, according to the Tax Directory.

- **The flow of credit to the Private Sector has increased to Rs 379 billion in 2013-14 as compared to (negative) Rs 19 billion in 2012-13**

This reveals much less "crowding out" of the private sector by govt borrowing and is clearly a welcome development. But much of the incremental credit may have gone to support working capital need as opposed to fixed investment. This tends to be confirmed by the fact that private investment fell to an all time low of 8.9% of the GDP in 2013-14 as compared to 9.6% of the GDP in 2012-13. Private investment (at constant prices of 2005-06) in the manufacturing sector fell sharply by 27.0% in 2013-14.

- **Agricultural Credit has increased by 15.91% in 2013-14, from Rs 336 billion to Rs 390 billion**

This demonstrates the higher priority that the Government is attaching to the development of the agricultural sector. The biggest percentage increase is in the case of the Zarai Taraqiate Bank Ltd (ZTBL), which has the burden of a large volume of bad debt. Commercial banks will have to be motivated to increase more their agricultural lending.

- **KSE index has gone up by 48.8% from 19916 to 29653**

This was likely to happen given the trust and confidence that investors in the KSE have on a business-friendly government like the PML(N). But this is not a new phenomenon. The market had already shown buoyancy in 2012-13, with the KSE 100 Index rising even more by 52.78%. Also, based on SBP data, the index increased by 41.16% and not 48.8% in 2013-14.

- **Market Capitalization has increased by 44.44% in rupee terms from Rs 5.04 trillion to Rs 7.28 trillion. The increase in US $ terms in 2013-14 was 43.85% from $ 51.3 billion to $ 73.80 billion**

This is clearly a reflection of the rise in the KSE index. But, as mentioned above, there was also a big increase in market capitalization in 2012-13 of 46.52%, from Rs 3.52 trillion to Rs 5.15 trillion. Here also, the increase in 2013-14 is overstated. According to the SBP, the growth in market capitalization (in rupee terms) is 36.24%, and not 44.44%. However, it is still large.

- **The Exchange rate (Rs per US $) has appreciated in nominal terms from 99.66 Rs in end-June 2013 to Rs 98.74 in end-June 2014**

This has already been referred to as a major achievement by the PML(N) government. But this has largely happened on the basis of large one-off inflows and a big increase in external borrowing. The underlying balance of payments position has not improved as indicated by a deterioration in the current account deficit and little improvement in non-debt creating capital inflows.

There is need to let the SBP manage the exchange rate in an autonomous manner and prevent a too large an appreciation in the real effective exchange rate, which could have an adverse effect on the balance of trade.

In summary, IPR believes that there have been some significant achievements by the PML (N) government, especially in stabilizing the economy. But a strong and sustainable "economic turnaround" remains elusive in the presence of slow agricultural growth, loss of momentum in manufacturing, fall in investment and savings rates, severe energy shortages, stagnation of exports, low tax-to-GDP ratio and growing external debt burden. We hope that the economy will show major improvement in years to come.