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FALSE STATEMENTS BY IMF

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The Staff Report of IMF on the Ninth Review of the Extended Fund Facility to Pakistan was released a few days ago. This has been followed by a Conference Call to economic journalist by Mr. Herald Finger, the Mission Chief. The transcript of this press conference was released on the 13th of January 2017.

The economic journalists must be commended for asking some very relevant questions on the on-going IMF program. In turn, Mr. Finger has patiently responded to each question. Unfortunately , there are a number of factual errors in the answers. This may be due either to wrong information being provided by the Authorities or a lack of awareness of latest trends or due to pressure to demonstrate that the Program is performing well and that the Staff Mission has been successful in inducing improvement in the economic indicators through promotion of appropriate actions.

The first problematic statement is that there is a process of `continuation of gradual recovery` of the economy in 2015-16. The GDP growth rate has risen from 3.7% to 4.2% in the first two years of the Program. In 2015-16, the growth rate is expected to rise further to 4.5%.

However, there have been a number of developments which could impact negatively on the growth rate in 2015-16. The cotton crop has failed and output is likely to be down by over 18%. This alone can reduce the GDP growth rate by one percentage point, given the role of cotton in the national economy. Exports have plummeted by over 14% in the first six months. Imports have grown in overall quantity terms, thereby adversely impacting on production in import-substituting industries. Further, the largest industrial plant of Pakistan , the Pakistan Steel Mills, is shutdown. Therefore, it is unlikely that the GDP growth rate will substantially exceed 3 percent in 2015-16.

The second important statement by Mr. Finger is that `over the last decade or so poverty has come down in Pakistan`. This is probably true for the fast growth period from 2003 to 2008. But, thereafter, the rise in per capita income has been low at about 1% annually and the unemployment

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rate has gone up from 5 to almost 6%. In addition, real food prices have increased cumulatively by 31% over the last decade and nutrition standards are down to crisis levels. Given these developments, it is unlikely that poverty has fallen. According to some estimates (e.g. by SPDC) the number of poor is increasing annually by over three million. The pressure for fiscal contraction under the IMF program has probably been one factor contributing to the recent increase in poverty.

There are also a number of factual inconsistencies in the statement by Mr. Finger on the state of public finances. He asserts that `the reduction in fiscal deficit is a major achievement of the Program`. The fiscal deficit is projected to come down to 4.3% of the GDP in 2015-16 from 8% of the GDP in 2012-13. However, in the latter year, there was a retirement of circular debt of the magnitude of 1.4% of the GDP. Currently, these liabilities have exceeded 2% of the GDP and inclusive of this the fiscal deficit will reach at least 6.3% of the GDP in 2015-16. This indicates that the underlying magnitude of the fiscal deficit remains high.

Further, the cash deficit may exceed 4.3% of the GDP in 2015-16 due to the cost of the PM's agriculture relief package, higher tariff differential subsidy following the reduction in electricity tariff by Rs 3 per Kwh, lower revenue from the Gas Infrastructure Development Cess, lower cash surplus by the Provinces and so on. In fact, it will not be surprising if the fiscal deficit in 2015-16 exceeds the level attained last year of 5.3% of the GDP.

Mr. Finger has also stated that `the majority of revenues is through Customs and lower oil prices are hurting the (tax) collection efforts`. There was a time when customs duty was the largest source of revenue but now it contributes only 12% to FBR collections. Even if other taxes at the import stage are included the share remains below 40%.

Contrary to perceptions, lower oil prices have actually created space for higher tax rates and revenues. Currently, the general sales tax rate on the highest consumption-volume petroleum product, high speed diesel oil, has been fixed at 51%, three times the standard rate of 17%. In addition, both statutory and regulatory duties have either been introduced or increased on oil imports. These two measures have contributed to additional revenues of over Rs 100 billion.

There is also a statement that `the number of taxpayers has increased by more than 200,000`. Analysis of the tax directory for 2013 and 2014 respectively reveals that the number has increased by 65,283 or 8% only. Further, it is asserted that the `number of audits and also the collection through audits has increased`. Actually, the peak collection from demand following audit was attained in 2011-12 at Rs 130 billion, equivalent to 17.6% of total income tax revenues. It was lower in 2014-15 at Rs 116 billion or 11.1% of collection.

The IMF Mission Chief also states that `Pakistan collects 11% of GDP in tax revenue. This is significant improvement from where it started at the beginning of the Program`. Actually, the level of 11% has been reached by including Gas Development Surcharge and Gas Infrastructure Development Cess as tax revenue. There is a Supreme Court judgment that the latter is a non-tax source of revenue, while the former has been shown historically in non-taxes. Also the rise in the tax-to-GDP ratio is a modest 0.6 percentage points since 2011-12.

One of the most surprising statements by Mr. Finger is that 'load-shedding was quite significant at around 8 to 10 hours a day, which has come down to below two hours in many segments of industry'. In fact, there was an increase in electricity consumption by industrial sector in 2014-15 of only 2 percent. This implies that the consumption per industrial unit may have actually fallen. For units in Punjab, there is the additional problem of gas load shedding during winter. It is highly unlikely that the load shedding situation has improved to the extent claimed. The Government keeps reassuring that this problem will only be solved by end-2017.

Finally, the assessment by Mr. Finger is that `the chances of completion of the program are good`. This will , of course, depend on the liberal continuation in program waivers as has been the case in the reviews up to now. The decision point is likely to be reached at the time of the framing of the Budget for 2016-17. The Government will require additional `fiscal space` to accommodate CPEC projects in the PSDP and to push for faster growth prior to the elections.

Currently, the macroeconomic framework in the Program projects that development spending will fall from 3.8% of the GDP in 2015-16 to 3.7% in 2016-17. Simultaneously, there is to be a big reduction in the fiscal deficit from 4.3% of the GDP to 3.5%. These projections clearly do not provide the necessary fiscal space. As such, the Fund will have to accept the need to shift gear from stabilization to growth if the Program is not to end prematurely.

Overall, there is a sense of disappointment about the quality of review by the IMF. Many of the positive findings are based on erroneous data. The Government has very skillfully handled the IMF.