INTERNATIONAL THE NEWS

25th December, 2019

Mehtab Haider

IMF's new conditionalities: Mini-budget on the cards

ISLAMABAD: After revising downward the FBR's target from Rs5.5 trillion to Rs5.238 trillion, Pakistan has agreed under the new structural benchmark condition with the IMF to take 'additional measures' on the eve of presenting the budget review before parliament by end of February 2020. This indicates that a mini-budget is on the cards if the need arises to achieve the envisaged annual targets for the current fiscal year under the IMF program.

On the other side, the non-tax revenue target has also been jacked up by 0.8 percent of GDP to compensate the shortfall on front of FBR tax collection and keeping the budget deficit, especially the primary deficit, within the desired limits.

"On the basis of the review's findings, we will implement 'additional measures' as needed to ensure that FY 2020 annual targets are observed," the Memorandum of Economic and Financial Policies (MEFP) dully signed by Adviser to the PM on Finance Dr Abdul Hafeez Shaikh and Governor SBP Dr Reza Baqir stated under the IMF's $6 billion Extended Fund Facility (EFF).

According to MEFP document, in line with the recently enacted Public Financial Management (PFM) Act, "we initiated the required analytical work and data gathering for the timely preparation of (i) a mid-year budget review and (ii) a strategy paper by March 15, 2020.

"We will present the budget review to Parliament by end-February (new end-February 2020 SB) to guide implementation of the FY 2020 budget, containing budget and actual comparisons of revenue, expenditure, and financing through H1 FY 2020 as well as an assessment of the budget estimates for the entire budget year. On the basis of the review's findings, we will implement 'additional measures' as needed to ensure that FY 2020 annual targets are observed" the MEFP stated which was released through IMF's review report.

Advance tax policy reforms. These will moreover help us to prepare the key elements of the FY 2021 budget. With support from IMF-provided technical assistance, we have identified the following key priorities: (i) Corporate Income Tax (CIT) reform so that it is simpler and with less exemptions and crediting schemes; ii) continue with the simplification of the sales tax on goods with further streamlining of exemptions and preferential rates; and iii) harmonization of the service sales tax base and rates in collaboration with the provinces.

To this end, the MEFP states that we will establish a joint working group that will provide recommendations on tax harmonization to be approved by the Council of Common Interest (CCI) by end-March 2020. The approved recommendations will be incorporated in the FY 2021 budget.

Press ahead with PFM reforms: Our aim is to instill budgetary discipline and transparency and build confidence that resources are being spent properly. Key immediate milestones include the preparation of the first fiscal risk statement, finalizing the budget manual by end-December 2019, and developing a PFM reform strategy. We have also initiated the work to introduce a single treasury account (TSA) by finalizing the inventory of government accounts by end-December 2019 and establishing a dedicated TSA implementation team by the same date.

We plan to have the TSA-1 system functioning by end-September 2020. We will request technical assistance on this implementation.

Strengthen and streamline Pakistan's tax policy and administration frameworks. To this end, we will: (i) build capacity on tax policy matters in the Ministry of Finance with a view to establishing a Tax Policy Unit; (ii) establish a macro-fiscal unit in the MoF by end-September 2020 for proper identification and monitoring of macroeconomic and specific fiscal risks; and (iii) create a new semi-independent national tax authority tasked with tax administration.

Deepen fiscal coordination with the provinces. We will launch regular coordination and consultation meetings between the federal and provincial tax authorities, by calling for quarterly meetings of the Fiscal Coordination Committee, to facilitate, inter alia, the work towards full harmonization of the tax base. This work will be designed under the auspices of the National

Finance Commission (NFC). Moreover, the provinces will step up their efforts to improve tax collection, in particular sales tax on services, property tax and agricultural tax income.

We will avoid the practice of issuing new preferential tax treatments or exemptions (new continuous SB) as we recognize that these distortions erode the tax base, weaken fiscal.

Meanwhile, the International Monetary Fund (IMF) has revealed that the circular debt of Pakistan's power sector stood at Rs1,690 billion or 4 percent of GDP till end of first quarter (September 30) of the current fiscal year.

The IMF has made it clear that the government will have to hike tariffs for both gas and electricity sector by end December 2019 and January 2020 respectively. The IMF also asks for bringing amendments into regulators of electricity and gas sectors known as Nepra and Ogra acts with approval of the Parliament. "The upcoming Nepra amendments will be aimed at granting power to the regulator to notify its determined tariff automatically in order to avoid delays in issuance of notification" the IMF's Resident Chief in Pakistan Teresa Daban Sanchez told during a seminar organised by Sustainable Development Policy Institute (SDPI) here on Tuesday.

The IMF chief said that she had never seen power sector for facing such problems in any other part of the world than it was facing in Pakistan as the tariff were not adjusted for months and years. The tariff, she said, should be aligned with the cost and for protecting the poor segment of the society up to using 300 units in shape of subsidies it protects 70 percent consumers of electricity from any hike.

On gas sector, the IMF report states that Pakistani authorities are taking steps to improve performance in the gas sector. The adjustment of tariffs in July and the upcoming adjustment by end-December 2019, based on the regulator's mid-year decision on tariffs, are key measures to stop the flow of arrears in the sector.

Recognising the need to improve performance, the two gas companies have prepared plans, approved by the Economic Coordination Committee, aimed at significantly reducing unaccounted for gas (UFG) losses. Salient elements of the plans include, inter alia, improvements in infrastructure, rehabilitation of networks, and theft control. The IMF staff urged the authorities to proceed expeditiously on these and other initiatives, including the amendments to the Ogra Act to ensure timely notification of tariffs.

On power sector's circular debt, the IMF report says that the amount of new circular debt was Rs465 billion, with around 1/3 of this amount coming from the inefficiencies in the DISCOs described above. Another significant source of circular debt, over 40 percent of the accumulation, comes from policy decisions related to the provision of unbudgeted subsidies, government provided subsidies that remain unpaid as there is no allocation in the budget, and delays in tariff notifications, whereby the government does not proceed with timely notification of tariffs. Addressing these two last sources of arrears has been a key priority of the Fund-supported programme.

The remaining accumulation of arrears stems from the financial costs generated by the existing stock of circular debt, including significant late payment fees payable to producers.

The IMF's staff report on Pakistan's economy stated that stronger efforts are needed to improve the viability of the power sector, and tackle rising arrears. At end-September, the stock of power sector arrears stood at Rs1,690 billion (about 4 percent of GDP), of which Rs465 billion were accumulated in FY 2019.

The main contributors to these new arrears were technical and distribution losses, delays in updating tariffs, and provision of unbudgeted subsidies.

These efforts are already showing some results, with accumulation of new arrears falling from about Rs38 billion/month in FY 2019 to around Rs10 billion/month in the first three months of FY 2020. The authorities remain committed to bring the flow of power sector arrears to zero by end-2023.

The IMF staff report urged the authorities to swiftly implement the comprehensive plan to reduce the flow of circular debt. The plan, prepared in consultation with international partners and IMF staff, aims to reduce the annual flow of circular debt from the current level to around Rs50–75 billion by FY 2023 through improving collection and reducing losses, streamlining tariff updates, and rationalising subsidies. Monitoring of the plan will take place through implementation reports published by the Ministry of Energy.

Key measures of the plan include: (i) timely updating tariffs, including the Q2 FY 2020 adjustment for capacity payments to take place by end-January (new end-January 2020 SB); (ii) streamlining of tariff procedures and reintroducing surcharges via amendments to the Nepra Act to be submitted to Parliament by end-December (modified end-December 2019 SB); (iii) improving efficiency and collection; and (iv) rightsising of subsidies.