

IMF agreement: Electricity prices to be hiked quarterly

ISLAMABAD: Pakistan has agreed with the IMF to further hike the electricity tariff on quarterly adjustments basis by end of the next month.

The IMF has also placed implementation on action plan under the Financial Action Task Force (FATF) into structural benchmark till end October 2019 in order to exit the country from the grey list.

“A second quarterly adjustment will take place before end-August. Moreover, the FY 2020 electricity tariff schedule will be notified as determined by the regulator by end-September 2019 under structural benchmark” stated the IMF.

The staff appraisal report of IMF released on Monday stated that Pakistan’s economy is at a critical juncture. “Pakistan’s economy is facing risks of hike in oil prices in international market and implementing policies under the IMF programme,” the IMF’s Mission Chief Ernesto Ramirez-Rigo said in his teleconference from Washington DC on Monday. He said that the skepticism outside the government was understandable but this time the government took prior actions to demonstrate its will to undertake key structural reforms.

The IMF staff report states that the effectiveness of Pakistan’s AML/CFT regime must be urgently strengthened to support its exit from the Financial Action Task Force (FATF) list of jurisdictions with serious deficiencies.

Pakistan was placed in the FATF list in June 2018 owing to shortcomings in effectively addressing terrorist financing risks. “The authorities are stepping up efforts to implement all measures committed to in an action plan with the FATF (end-October 2019 structural benchmark) to support the country’s exit from the FATF list,” said the IMF.

The National Executive Committee (NEC) is monitoring and coordinating efforts to implement the FATF action plan. The Asia Pacific Group on Money Laundering is expected to discuss Pakistan’s mutual evaluation report in August 2019. The authorities will work with technical assistance providers, including the IMF, to complete the action plan and further strengthen the effectiveness of the AML/CFT regime.

On power sector, the IMF states that an adequate pricing structure reflective of costs is essential to eliminate the accumulation of circular debt as new capacity comes into the system, and to make the sector a more attractive investment opportunity.

The authorities have initiated the automatic quarterly adjustment of tariffs with a first tariff increase of over 10 percent to generate Rs150 billion in additional revenue (prior action). This adjustment will help to address the circular debt accumulated over the first half of FY 2019.

Going forward, the authorities are committed to streamlining and making more predictable the tariff notification process, it states and added that to this end, amendments to the NEPRA Act would be submitted to parliament by end-December 2019 under structural benchmark with a view to (i) ensuring full automaticity of the quarterly tariff adjustments and (ii) eliminating the gap between the regular annual tariff determination by the regulator and the notification by the government. The authorities will prepare by end-September 2019 (structural benchmark) a comprehensive plan to reduce circular debt, with quarterly targets for the reduction of arrears through improvements in collection, efficiency gains, and enhanced governance.

The plan will also include options to tackle the outstanding stock of circular debt. The authorities are also taking actions to improve performance in the gas sector. To this end, a multi-pronged strategy includes: (i) the prompt adoption of the FY 2020 gas tariffs as proposed by the regulator to become effective on July 1, 2019 (prior action); (ii) the reduction of losses in the sector through the preparation of a comprehensive plan for government approval by end-September 2019 and to be monitored through published quarterly reports; (iii) greater participation of the private sector in the gas sector, including via the unbundling of the two gas companies; and (iv) amendments to the Ogra Act to ensure the regular and timely notification of end-consumer tariffs. 28. The policy of protecting lower-income households from higher energy prices will continue. Currently, households consuming 300 units (kwt-h) or below (about 70 percent of all household consumers) are insulated from annual tariff increases. The authorities will continue with this practice and will moreover allocate for this year a new subsidy equivalent to 0.1–0.2 percent of GDP to insulate those same consumers from the impact of the recently introduced quarterly tariff adjustment.

The IMF states that the legacy of misaligned economic policies, including large fiscal deficits, loose monetary policy, and defense of an overvalued exchange rate, fueled consumption and short-term growth in recent years, but steadily eroded macroeconomic buffers, increased external and public debt, and depleted international reserves. Structural weaknesses remained largely unaddressed, including a chronically weak tax administration, a difficult business environment, inefficient and loss making SOEs, amid a large informal economy. Without urgent policy action, economic and financial stability could be at risk, and growth prospects will be insufficient to meet the needs of a rapidly growing population.

The authorities' comprehensive economic reform program, supported by the EFF, aims to stabilize the economy and lay the foundation for robust and balanced growth. Key elements include: A decisive fiscal consolidation to reduce public debt and build resilience, starting with the adoption of an ambitious FY 2020 budget. The adjustment will be supported by comprehensive efforts to drastically increase revenue mobilization by 4 to 5 percent of GDP at the federal and the provincial level over the program period; Expanding social spending, including through the strengthening and broadening of safety nets to support the most vulnerable; A flexible, market-determined exchange rate to restore competitiveness, rebuild official reserves, and provide a buffer against external shocks. This will be supported by an appropriate monetary policy to shore up confidence and contain inflation, conducted by an independent central bank; Energy sector reforms to eliminate quasi-fiscal losses and encourage investment, including by depoliticizing gas and power tariff setting and over the program period, gradually bringing the sector to cost recovery; and Structural reforms through strengthening institutions, increasing governance and transparency, and promoting an investment-friendly environment necessary to improve productivity, entrench lasting reforms, and ensure sustainable growth. Strong financial assistance by Pakistan's international partners will support the EFF. The Fund-supported program is expected to coalesce broader support from multilateral and bilateral creditors in excess of US\$38 billion, which is crucial for Pakistan to meet its large financing needs in the coming years.

The IMF pointed out that in addition, significant financial support by official and bilateral partners aims to provide an important safeguard. The program is expected to mobilize total financing of around \$38.6 billion over the three years from Pakistan's international partners. The first 12 months are fully financed with the expected support from multilateral development banks and bilateral creditors as follows: China \$6.3 billion, Saudi Arabia \$6.2 billion, UAE \$1 billion, the World Bank \$1.3 billion, the Asian Development Bank \$1.6 billion, and the Islamic Development Bank \$1.1 billion. To support long-term debt sustainability, the authorities have also received firm commitments from key bilateral partners (China, Saudi Arabia, and UAE) to maintain their exposure throughout the program period and to adjust the financing modalities to ensure that the new financing will be consistent with the programme debt sustainability objectives by ensuring a manageable external debt servicing profile beyond the end of the IMF-supported program.

The IMF says that risks to the IMF program are significant, but the program offers Pakistan an opportunity to break from the unsustainable policies of the past.

Pakistan's track record on program implementation has been weak, punctuated by incomplete reforms and policy reversals. The authorities' upfront efforts, exchange rate flexibility, fiscal consolidation and tariff adjustments in particular, may be received with strong backlash from vested interests and the wider population as the benefits may not be immediately obvious.

Pressures to reverse policies may quickly emerge, which must be resisted to allow reforms to take hold and restore confidence. Similarly, the fruits from structural reforms may take years to materialize, possibly leading to reform fatigue and backtracking of policies.

Strong ownership and an unwavering commitment to program implementation will be critical to ensure program success and turn Pakistan's economy around. In this context, international support will hinge crucially on the implementation of these reforms. Other political and external shocks may further complicate an already challenging environment, the IMF concluded.

Mehtab Haider