

Can Pak economy survive without IMF?

Macroeconomic fundamentals deteriorated because of tight monetary, fiscal and regulatory adjustments which have squeezed national output, increased cost pressures and slowed down the GDP growth from 5.53% to 3.29%. On account of country's contractionary monetary policy regime, the World Bank has cut down Pakistan's real GDP growth projections from 2.7% to 2.4% for FY2019-20. Country's deterioration at the macroeconomic level has been reflecting in depressed demand dynamics of the private sector's credit momentum which actually started from the third quarter of FY19 and later aggravated in first quarter of FY20. According to State Bank of Pakistan (SBP), entire private sector businesses of the country preferred to retire Rs 85 billion loans during July-Sept 2019 vs. credit off-take of around Rs 99 billion last year during the same quarter. An IMF mission is in Islamabad, scrutinizing underlying reasons to reach at the conclusive diagnosis of Pakistan economic performance at critical times. FBR has been facing massive tax shortages hits to peak levels of approximately Rs.600 billion and which has further widened the tax gap, fiscal slippages, country's circular-debt resurfacing, 9-year high inflation of 14.6% and mini-budget just around the corner.

Having said that, despite IMF's interference and tough conditions in our previous bailout programme, it was the only IMF programme in which Pakistan managed a good growth of 5.80%. During the same period, inflation and interest rates remained at historic low levels, and our currency was stable as the Rupee was valued at PKR 104 against the US dollar. This restored investors' confidence in Pakistan.

Period	Before IMF	After IMF	Under ongoing
	in 2013	Program in 2017	IMF program
Interests Rates	9%	5.75%	13.25%
GDP growth	3.60%	5.80%	2.40%
Currency Parity	99.50	*104	155

(source: SBP, IMF & Finance Ministry)

* PKR hit to 98 in open market at one point in time during period

With aforementioned positive indicators few years ago, Pakistan's economy has yet again slumped into a deteriorating position. Our GDP is sliding down and our economy is presently in the state of stagflation, as we head towards a recession. Devaluation of the PKR has had a negative impact on the competitiveness of the economy. This raises eyebrows as to why the current IMF programme is not being managed properly in terms of its implementation, and who is responsible for such a failure?

According to media sources, government officials have requested IMF to further revise downward the FBR tax revenue target on account of widening FBR tax-gap and economic slowdown. The original target of Rs 5,503 billion in FY2019 is 43.72% higher than actual tax collection of Rs 3,829 billion last year which was unrealistic and impossible to achieve.

Since, IMF has already revised downward FBR tax revenue target by Rs 267 billion (from Rs 5,503 billion to Rs 5,236 billion), possibility of further downward revision in tax revenue target is unlikely.

In the wake of Pakistan-IMF talks, any breakdown in the negotiations, or any further assistance from IMF, it is presumed that country will face a daunting task on international front and might trigger a default, although it is not advisable to exit IMF program so early. It is ensured that bailout programmes under the IMF ideally seek to bring fiscal discipline, which is an important prerequisite for macroeconomic stability in any country. Pursuant to the fiscal policies set out in the IMF programme(s), finance ministry tends to avoid giving tax concessions and preferential treatments and works on plugging leakages to create fiscal resources to achieve the required objectives. However, in case of eventuality re-profiling of economy is inevitable and may prove to be blessing in disguise. The cost -benefit analysis in such a scenario is provided hereafter:

Re-profiling of the economy

Pakistan can shift gears, going from an embarrassingly low growth to a high GDP growth which may pave the way for Pakistan to live without the IMF, and come out of a vicious debt trap. The financial impact of the following three factors on our economy would be PKR. 5,969 billion. This can be seen as under:

S. No.	Pakistan's Gross Saving	(Cost) /Savings	Reference
Rs. In Billion			
1.	Re-profiling of debt	(56)	Table 1
2.	Decrease on Fiscal deficit	8,125	Table 2
3.	Cost of direct subsidy to exporters	(2,100)	Table 3
Net Increase		5,969	

1. Re-profiling of debt

With the re-profiling of debt, Pakistan's incremental cost would be around \$80 million per year, leading to aggregate cost of Rs. 56 billion at PKR 140 as under:

TABLE 1				
Differential Cost Analysis (in million US dollars)				
Existing Source Difference	Amount Amount	Interest Rate	Re-profiling	Interest Rate
IMF, WB, ADB & others (4.50%)	18 billion (405)	2.50%	Commercial	7%
Hot Money 325	5 Billion	13.50%	Commercial	7% 6.50%

* We have taken weighted average of \$9 billion funding for remaining 5 years. Cost of Re-

* It is estimated that USD 5 billion will be raised through profiling (80) million

hot money till June 30,2020 year

for 1

(Present US\$ 3 billion is outstanding).
 five years (400) million

For

In

PKR @ 140 PKR (56) billion

Pakistan to get \$ 18 billion from the World Bank, Asian Development Bank, the IMF and other bilateral/multilateral sources over the next five years. However, by incorporating \$9 billion of IMF, WB and ADB sources, country to incur negative \$ 405 million cost against the weighted average of funding amount in remaining five years. In the meantime, overseas investors are pouring in 'hot money' in the Pakistani jurisdiction, earning with a substantial rate of return at 13.5% against the six-month T-bill paper (PKR appreciation against the US dollar stretches the total return of hot money inflows to 17-18% on the invested amount). Based on the current economic scenario, we are estimating an inflow of around \$5 billion worth 'hot money' into the country during current fiscal year.

On the other hand, Pakistan might face adverse FATF sanctions if it does not strictly adhere to the FATF action plan. Shifting to commercial loans will be a herculean task. Pakistan has to borrow from commercial banks especially from China and Gulf countries.

2. Re-profiling of the fiscal deficit

With every percentage point increase or decrease in the T-bill rate, fiscal deficit consequently increases or decreases by a net PKR 250 billion. It is suggested a reduction in the interest rates; to bring it down to 7% in order to accumulate projected savings of PKR 8,125 billion over the next 5 years. This has been illustrated as under:

TABLE 2

Impact of Re-profiling on Fiscal Deficit (Positive Side) (in PKR)			
Borrowing	Re-profiling	Difference	Amount
13.50%	7%	6.50%	250 billion
Fiscal deficit down in 1 year			1,625 billion
For five years			8,125 billion

With a cut in interest rates, the industrial sector activity will revive, and inflation will slide with demand is expected to increase. Pakistan would, therefore, have more fiscal space with additional resources of PKR 5,812 billion to push the GDP growth forward.

3. Subsidy to exporters

It is projected an increase in Pakistan's exports up to \$30 billion by giving a cash subsidy of 10% direct or indirect, of the total exports to the exporters. The value addition to the overall economy will also increase.

The benefit mentioned hereinabove, is linked with a USD \$ parity of 140 PKR, in order to restore competitiveness of the country with the rest of the world.

TABLE 3

Subsidy to Exporters (positive side)

Projected Exports (per annum)	Exports in 5 years	PKR conversion at PKR.140	Drawback
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US \$30 billion	US \$150 billion	21,000 billion	2,100 billion
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> In addition to the above:

* The Federal Government must pursue implementation of the reforms recommended by the Tax Reforms

Commission (TRC) in order to increase tax revenue, expand the tax net, digitize the taxation system, and enforce

an equitable taxation system for sustainable economic growth.

* The country must prioritize spending, rationalise expenditure and shift towards development and quality of spending with the cost benefit analysis of incremental spending.

* The incumbent government should also strictly adhere to pursue a fiscal management strategy to honor the Fiscal Responsibility and Debt Limitation Act, 2017 to reduce public debt and have in place an effective debt management strategy.

* The National Finance Commission must be remodeled.

* The FBR had raised total taxes of PKR 3,829 billion during the year 2018-19. The Nominal GDP growth of the country is projected at 15% (Real GDP growth 3% + Inflation 12% = bringing impact of 15% nominal GDP growth to PKR.574 billion), and after incorporating PKR.735 billion worth additional taxes of the FBR, the total tax collected cannot be more than PKR 5,138 billion.

* Despite a downward revision, FBR's actual tax revenue collection stood at PKR 2,207 billion during July-Jan 2019-20, facing a cumulative shortfall of PKR 585 billion against target of Rs2,792 billion during July-Jan 2019-20. While, FBR had collected PKR 2,062 billion during July-Jan 2018-19 and PKR 1,995 billion during July-Jan 2017.

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FBR's Tax collection

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(PKR)	July-Jan 2019-20	July-Jan 2018-19	July-Jan 2017-18
	(Rs. Billion)	(Rs. Billion)	(Rs. Billion)
Actual Tax revenues	*2,207	2,062	1,995
Growth in revenue	**7.03%	3.35%	-
Targeted Tax revenues (Revised)	2,792	2,251	2,295
% of Target Achieved	79.04%	91.60%	86.92%

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* After taking into account around Rs 200 billion with respect to tax refunds, incremental Advances and Amnesty Receipts, Actual

tax revenues for July - Jan 2019-20 stood at Rs 2,207 billion.

** If we incorporate 14.60% inflation for Jan 2020 and 2% GDP growth, actual tax revenue grew by negative 9.57% vs last year (Increase in inflation causes an increase in tax revenues, reflecting +ve relationship between inflation & tax revenues).

* The FBR has to collect an additional tax revenue worth PKR 3,031 billion in the next five months (on average, this amounts to a staggering PKR 606 billion per month) to accomplish the revised target of PKR 5,238 set by the IMF in 2019-20.