BUSINESS RECORDER
Founded by M.A. Zuberi

More bad news on the economy

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In our recent submissions (BR: 19-6-2018), while commenting on the first eleven-month fiscal outcome, we had apprehended that the deficit could reach as high as 7%of GDP or Rs 2.4 trillion. However, a report has indicated that it may well be higher at 7.1% or Rs 2.45 trillion. Excluding circular debt settlement, this is the highest deficit since 2012, when it was recorded at 8%. Also, it is the second consecutive year witnessing a new wave of fiscal indiscipline in the country. It is worrying since it has happened in the backdrop of a successfully completed IMF program that saw a major fiscal adjustment of nearly 4%.

With such a heavy dose of over-spending, there is every likelihood that the external account would again register a monthly deficit of $2 billion taking the total to $18 billion or 6% of GDP, the highest in more than a decade. Not surprisingly, the SBP reserves have plummeted to below $10 billion, less than two months of imports, at the close of the fiscal year. Pakistan is exposed to significant risk of economic disruption. The Moody's downgrade of outlook, from 'stable' to 'negative', is an early warning signal for what can be expected unless corrective actions are adopted without further loss of time.

A more worrying development is the major slowdown in tax collections which has registered a paltry growth of 12%, only slightly better than 8% last year, but grossly below the growth of 20% registered in the first three years of the previous Government. This poor performance includes the tax receipts under the amnesty scheme. It is still not clear how much tax was received under the amnesty scheme. Some reports have indicated that Rs 72 billion have been received as taxes under the amnesty scheme. If we exclude this number, the latent growth in taxes comes to only 10%. Without amnesty receipts, tax collections growth is 10%. The tax shortfall is estimated at Rs 243 billion, or 0.6% of GDP has also contributed to high fiscal deficit. Equally importantly, the non-tax revenues, most notably GIDC, were significantly short as actual receipts in the first three quarters of the fiscal year amounted to only 39% of the budget. Even more disconcerting reports is that both Punjab and Sindh have overdrawn their balance from the SBP by Rs 50 billion and Rs 10 billion, respectively. This essentially means that far from contributing Rs 300 billion as surplus for the year, which would have acted to reduce overall fiscal deficit, the actual position would follow what happened last year, i.e., rather than surplus there a deficit of Rs.160 billion. The above factors have gone in bringing about a fairly disappointing fiscal outcome.

The momentum of tax reforms has completely broken down. The growth in the first three years has again given way to dependence on low tax elasticity as no further measures to raise taxes and to strengthen the tax system was undertaken. Unlike that, highly misplaced and unwarranted tax concessions have been given by authorities who lacked a true understanding of tax dynamics and based their decisions on half-baked ideas and gut-feelings. Much of that loss has yet to go into effect as it would be applicable during the new fiscal year. Evidently, unless major reversal of these relief measures is undertaken, the outlook for tax collections would remain negative in the next year also.

The tax amnesty scheme has not produced the kind of results that were paraded at the time of its launch and trumpeted in the closing weeks of its deadline before it was extended.

An issue that we recently mentioned is the gas pricing determined by Ogra, with an average increase of 46%. For nearly five years, the previous government did not revise the gas price taking refuge behind the declining international oil prices, which was only partly justified. In the meanwhile, huge arrears have emerged for both utility companies and need for price adjustment was urgent. The price hike would be nearly unbearable for the domestic consumers, where the required increase is worked out at 300%. What this means is that an average consumer paying a monthly bill of Rs 450 would face a revised bill of Rs 1350. This would be quite burdensome. There are others sectors that would also face high price increases, most significantly power sector, captive power, fertilizer (non-feedstock) and commercial, all of which would lead to secondary effects on consumer prices.

A sum of Rs 300 billion, nearly 1% of GDP, has been determined as the arrears of the two companies, which OGRA has asked them to recover in installments. This would be an added burden on the bills after the increased price. Some have raised the issue that such costs should not be recovered from those consumers who were not connected to the system when such arrears were accumulated for otherwise they would be paying for something they have not benefited from.

The Caretaker government would face a major dilemma in deciding whether to follow the advice of Ogra, like they have done in the case of petroleum prices or defer the matter for the next Government to decide. In all fairness, given the political considerations involved in delaying the price adjustment for nearly five years by the previous government, which were absent in the case of taking a decision on petroleum prices, the Caretaker government should leave the matter to the next Government, which would be able to explain to the people as to why and to what extent the adjustment in gas prices is required.

One thing the new government must undertake is to lay before the nation its full stock of all unpaid bills by the federal government, be that on any account. Circular debt (broken into tariff differential subsidies and others), unpaid subsidies of utility corporation, fertilizer, TCP and others are the leading items. A complete inventory of contingent risk should also be identified. Finally, as required under the FRDLA 2005, the government should disclose other contractual risks that are in the nature of contingent liabilities. Here such contracts would be required for disclosure like the IPPs (guaranteed through Implementation Agreements (IA)) and with suppliers of allied facilities, such as transmission lines, LNG supplies and terminal handling and pipeline construction. Such a record should enable a true assessment of what liabilities have been acquired by the Government and for which regular reporting is missing. This may also allow the Government to transparently let the nation that it has inherited these liabilities and that it should not be held accountable for their responsibility. But of course, the liabilities remain that of the Government and would have not implications for not paying them in course of time.

Given the above background, one can understand why the Fund was constrained, in its first post program report in December 2017, to highlight the risks to its lending to Pakistan. Things have slipped deeper into a morass since then. We have a very short window of time to begin the repair work, which would be highly challenging and people should brace for a new round of tough economic conditions comprising high inflation, expensive loans, tight monetary policy and difficult conditions in the external account.

(The writer is former finance secretary)