



Asia
Research Centre



Zentrum für Entwicklungsforschung
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External assistance to Pakistan

**CURIOUS CASE OF DUTCH DISEASE WITHOUT
THE OIL**

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Issues

2

- The WWC report—some positive signs
- Pernicious effects of assistance in the 1980s:
Abandonment of
 - tax reforms
 - “golden rule” and
 - fiscal responsibility since 1985
 - Stop-go aid, and domestic reform agenda
- Bonanza post 9/11—leveraging geographic rents
- Failure of most recent (2008) stabilization program
 - 2009 NFC assumptions subverted
 - 18th Amendment: unfunded mandates
- Deteriorating social outcomes
- Major focus on “standing on one’s own feet” needed

WWC report

3

GREATER REALISM—BUT IS IT ENOUGH?

Positive aspects of WWC

4

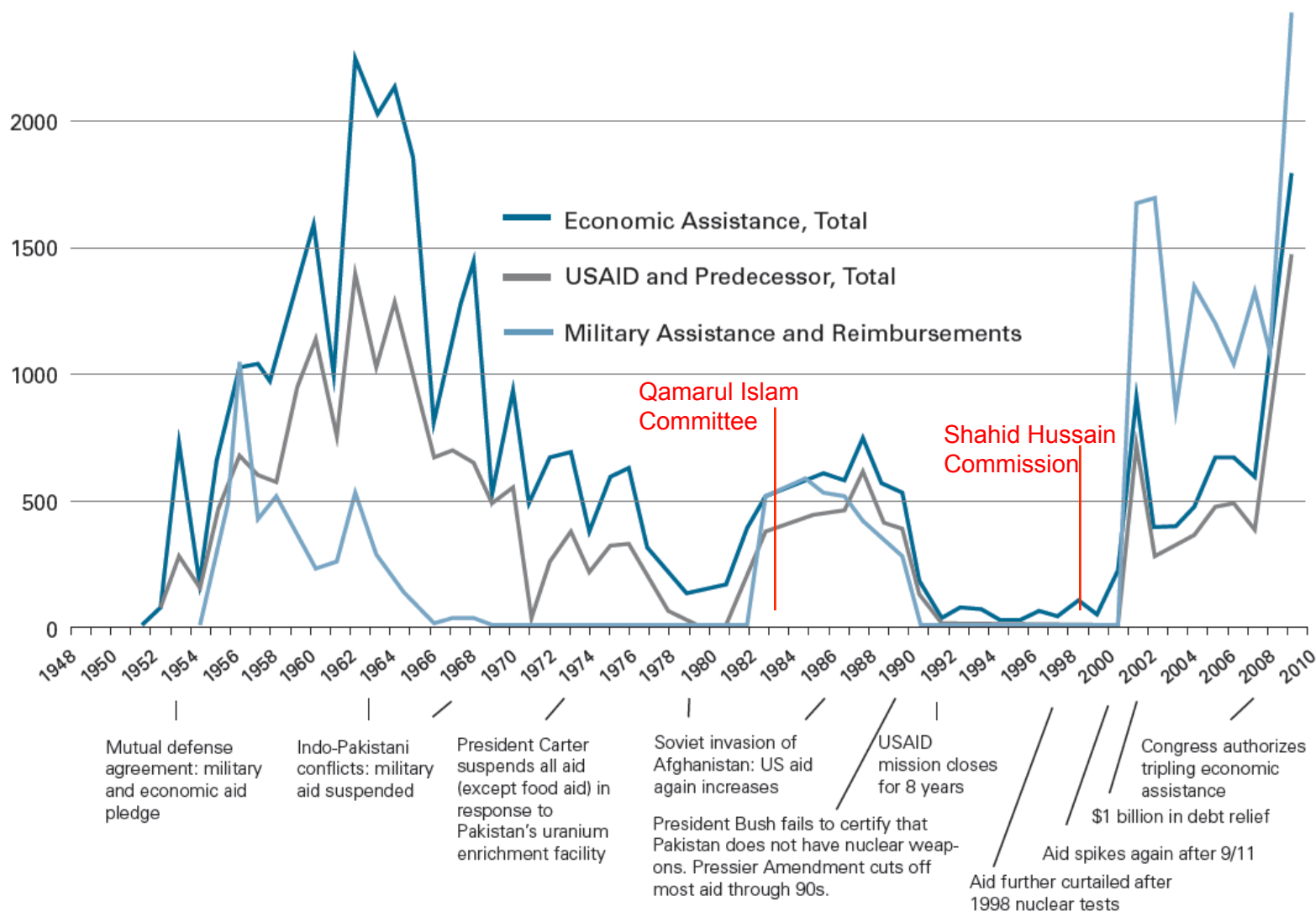
- Trying to avoid stop-go
- Political indication of continuing support
- Emphasis on good policy making:
 - Social services and effective provision for poor
 - Avoid “capture” by established interest groups, e.g., cash transfers
 - Run operations through Treasury Single Account (TSA) to know where the money goes
 - ✦ But where is the TSA?
 - Require co-financing for aid-supported projects
 - ✦ May improve portfolio of projects
- Does not ensure “Additionality”
 - May still substitute for domestic reform efforts
 - Need conditions on tax effort and domestic revenue generation

Pernicious effects of assistance in the 1980s

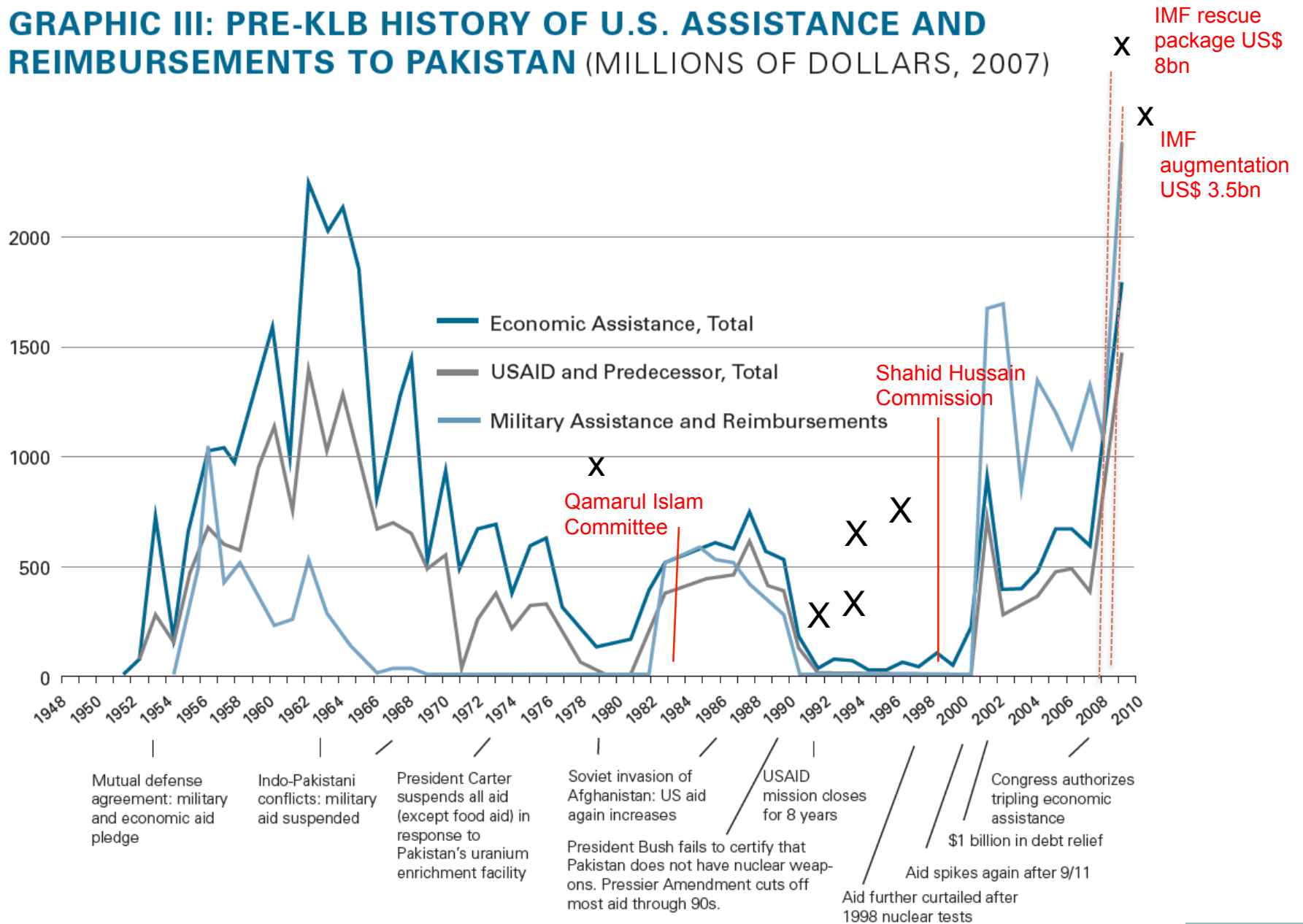
5

**ABANDONMENT AFTER FIGHTING THE
SOVIETS**

GRAPHIC III: PRE-KLB HISTORY OF U.S. ASSISTANCE AND REIMBURSEMENTS TO PAKISTAN (MILLIONS OF DOLLARS, 2007)



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Aid undercutting tax reforms

8

- Focus on tax reforms in early 1980s, following sanctions—military coup, nuclear program
- Qamar-ul Islam Commission 1982
 - 1983: tax/GDP ratio 14.5 %; Committee wanted 20%
 - Warned that the CBR is the “most corrupt of institutions and would negate any tax reforms”
- Reforms shelved with Afghan-related inflows that followed
- Also abandoned the “golden rule”, and borrowed for current spending from 1985 on
- Chipped away at Consolidated Fund—end of the TSA

The stringent 1990s: role of International Agencies

9

- US Aid withdrawn end 1980s, Pressler Amendment enforced
- But assistance continued under IMF SDR 4 billion (1988-2000)
 - US supported the programs, despite Pressler
 - Easy program with SOE losses outside program—still did not prevent “misreporting”
- GST introduced under IMF program in 1990
 - Operated as an “excise”, full of holes for special interests
- Series of programs faltered because of inability to meet conditions
 - ✦ GST exemptions; taxing agriculture
 - ✦ undrawn balances 50% of committed
 - Sanctions again, following nuclear explosions late 1990s
- Shahid Husain Report—after nuclear sanctions
 - Focused on arms-length integrated administration on modern lines using self assessment and information flows;
 - supported by \$135 m World Bank loan for tax reform program (TARP)—also co-financed by DFID

Post 9/11 Bonanza

10

LEVERAGING GEOGRAPHIC RENTS

Ill-effects of post 9/11 bonanza

11

- Again tax reforms abandoned—despite a show and dance
 - Although tariffs were reduced and self assessment introduced
- With capital inflows, and fixed exchange rate,
 - Domestic transactions of key sectors taken out of GST 2004 net by SROs (administrative orders)
 - Effective subsidy without alarming WTO
 - Audit abandoned in 2004
- TARP declared as “non-performing” in 2008; had done nothing in fact
 - Only after departure of Shaukat Aziz
 - Tax/GDP ratio down to 10% in prelude to macroeconomic crisis

2008 Stabilization Program

12

- 2008 proposals to Friends of Pakistan and IMF:
 - fix GST to return to 14% of GDP in 5 years
- Another rescue of TARP by Bank—Silvani (Ex-President of Argentine Revenue Authority)
- But did Fund program design + KLB spell the death knell of reforms?
- Qamar-ul-Islam Committee called CBR the most corrupt of institutions
 - But he had not seen the depths to which the FBR has plunged
 - Outright corruption and rent seeking
 - ✦ Together with legitimate breaks for friends and relatives
 - ✦ SRO283—April 1, 2011: breathes new life into SRO culture:
 - Rewarding friends and punishing enemies, without reference to Parliament
 - ✦ Foreign income exempt (coming in through remittances)
 - ✦ IMF retirees pay tax in the UK, US, but not if they live in Pakistan
- Budget system even worse
 - No TSA; inadequate tracking of spending

Macroeconomic collapse!!

13

- Largely due to failure to carry out their own proposed tax reforms
 - Refusal of government to give up SRO powers
 - Rely on Sindh card
 - Tax/GDP ratio falls further to 8.5% in 2011
- Consequence
 - NFC award is defunct
 - 18th Amendment devolution of spending nothing but unfunded mandates
- External crisis dwarfed by domestic borrowing
 - Roll over of 30% of GDP in next few months—entire stock of t-bills
 - Increasing reliance on short-term borrowing from banking sector to finance deficits
 - ✦ Facilitated by SBP purchasing of government paper from Banks—liquidity injections
 - ✦ Potential collapse of banking system
 - ✦ 90% of tax revenues now go to finance debt servicing
 - Temptation to wipe out liabilities by inflation—with disastrous political consequences

Collapse in services and social indicators

14

- Rising food insecurity
- Health care and education outcomes not even on the same page as other South Asia
 - Now falling behind sub-Saharan Africa
- Inter-provincial tax wars underway
- Collapse in public infrastructure
 - Energy and transport
- All due to lack of political will to tax friends and relatives of the party

Health and nutrition outcomes

15

- Resurgence of polio—eradicated in all parts of the world except Niger Delta
- Inability to handle infectious diseases: externalities with dengue
- Increasing nutritional vulnerability 2011 Nutritional Survey (MoH and Aga Khan University):
 - Alarming level of food insecurity (57% of households)
 - ✦ Concentration of malnutrition among women and children
 - ✦ Maternal anemia 49%; child stunting 43%; wasting 13%
 - ✦ Concentrated in Sindh, Baluchistan and FATA
 - Reflective of lack of government commitment to ensuring food security.

Social spending --health

16

Countries	Total expenditure on health as % of Gross domestic product					Public % GDP	Per capita govern
	2005	2006	2007	2008	2009	2010	2009
Nigeria	6.6	5.5	5.3	5.2	5.8	2.1	25
Brazil	8.2	8.5	8.4	8.4	9.0	4.1	335
Mexico	5.9	5.7	5.8	5.9	6.5	3.1	253
Afghanistan	8.8	7.8	7.6	7.4	7.4	1.6	11
Iran (Islamic Republic of)	5.7	5.5	5.5	5.5	5.5	2.2	105
Pakistan	2.8	2.7	2.6	2.6	2.6	0.8	7
Yemen	4.9	5.3	5.3	5.3	5.6	1.6	18
Bangladesh	3.2	3.4	3.5	3.3	3.4	1.1	6
India	4.2	4.0	4.0	4.0	4.2	1.1	13
Indonesia	2.1	2.3	2.5	2.3	2.4	1.2	29
Thailand	3.5	3.7	3.7	4.1	4.3	3.3	127
China	4.7	4.6	4.2	4.3	4.6	2.3	85
Malaysia	4.1	4.3	4.4	4.2	4.8	2.2	151
Philippines	3.6	3.6	3.5	3.6	3.8	1.3	23
Singapore	3.0	2.9	3.0	3.3	3.9	1.6	618

Source: WHO, NHA Database; Note: Pakistan budgetary spending on health in 2008/9 0.6% of GDP. Per capita government spending is in US \$ at the prevailing exchange rate. Public per capita spending 2010, World Bank, 2011.

Education outcomes (circa 2009) worse than Sub-Saharan Africa

17

	School enrollment primary (net)	Secondary enrollment (gross)	Adult literacy rate	
Pakistan	66.4	33.1	55.5	
India	91.4	60.0	62.7	
Bangladesh	85.3	42.3	55.9	
Sub Saharan African	75.1	36.0	62.3	
Malaysia	95.6	68.7	92.5	
Indonesia	95.3	79.5	92.2	
Iran	99.5	83.7	85.1	

Source: World Bank, World Development Indicators, September 2011

A coordinated agenda

18

**IMPROVING PUBLIC SERVICE DELIVERY FOR
THE POOR**

Need strong governance reforms

19

- Stand on own feet for needed infrastructure and basic public services
- Critical agenda for tax reforms: stop the cheats
 - Simple and comprehensive GST to generate full information
 - Interactions between CIT and GST to address informality
 - Minimum asset tax for both CIT and PIT liabilities against PIT and CIT liabilities—no exemptions for foreign sources (including IMF pensions)
- Consolidate bases
 - Provinces piggy back on the major taxes
- Arms length tax administration (SBP model) serving both federation and provinces
- TSA and transparency in spending—where does the money go and what are the results?
 - Information for better accountability

Some green shoots?

20

- Growing intolerance of incompetence and corruption
- Activist judiciary
- Free press
- But if political process is manipulated, there could be a severe backlash