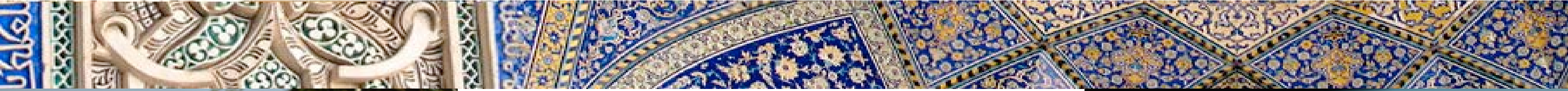


Pakistan's Program with the IMF 2013-2016

Jeffrey Franks
Middle East and Central Asia Department
International Monetary Fund

May 12, 2014

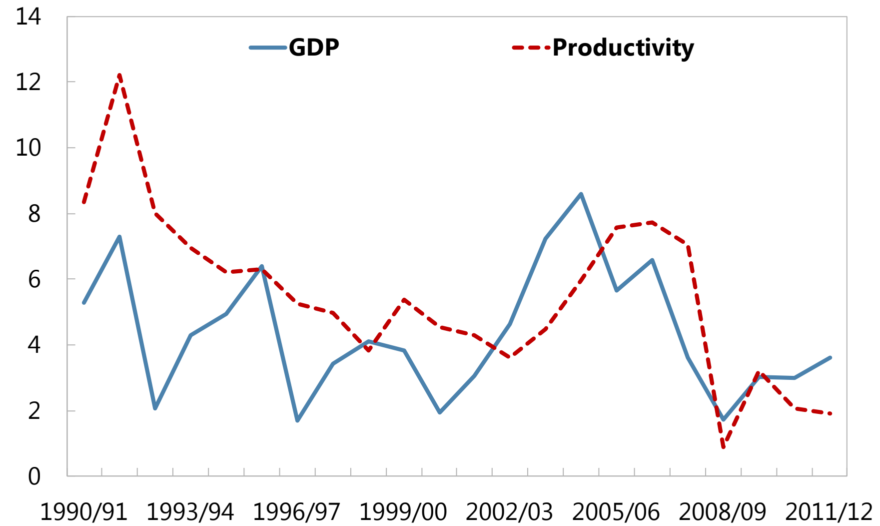
BEFORE THE PROGRAM

REAL SECTOR

- **Weak economic performance:**
  - Real GDP growth has been low
  - Private investment has fallen sharply

Pakistan: GDP and Productivity

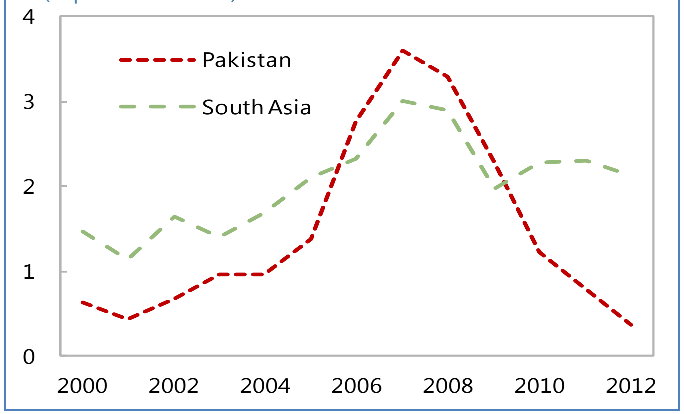
(In y-o-y percent change)



Sources: Pakistani authorities; and IMF staff calculations.

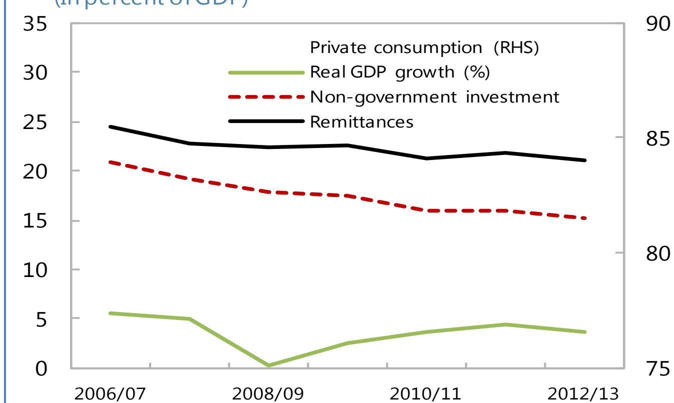
Foreign Direct Investment, 2000 — 2012

(In percent of GDP)



Consumption and Investment

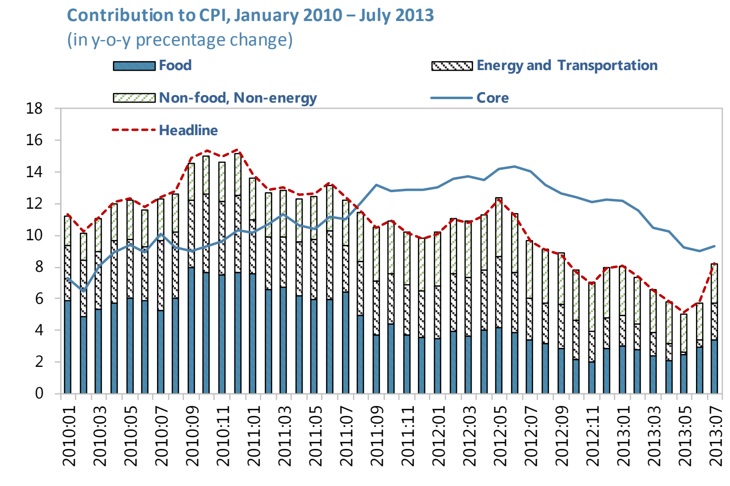
(In percent of GDP)



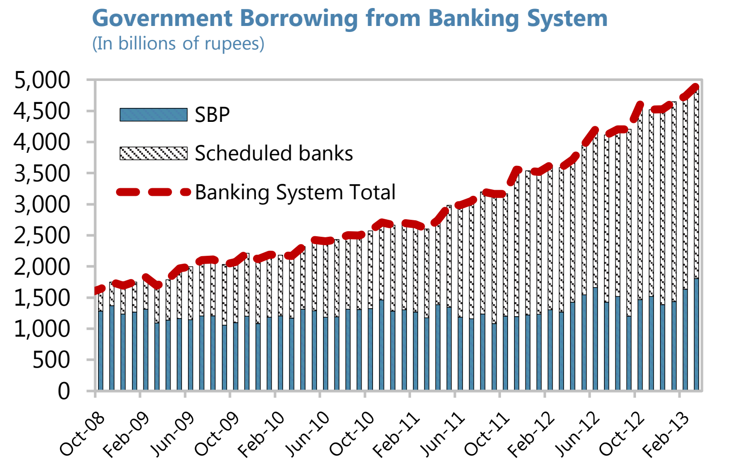
BEFORE THE PROGRAM

INFLATION

- **High and persistent inflation**
- **Driven in part by accommodation of the large fiscal deficits**



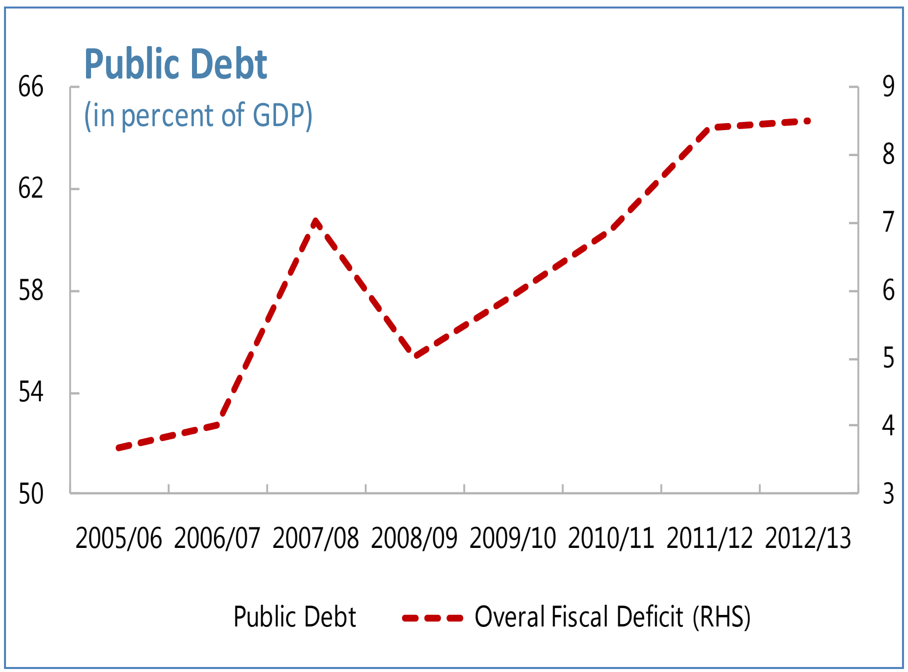
Source: State Bank of Pakistan and Fund staff estimates.

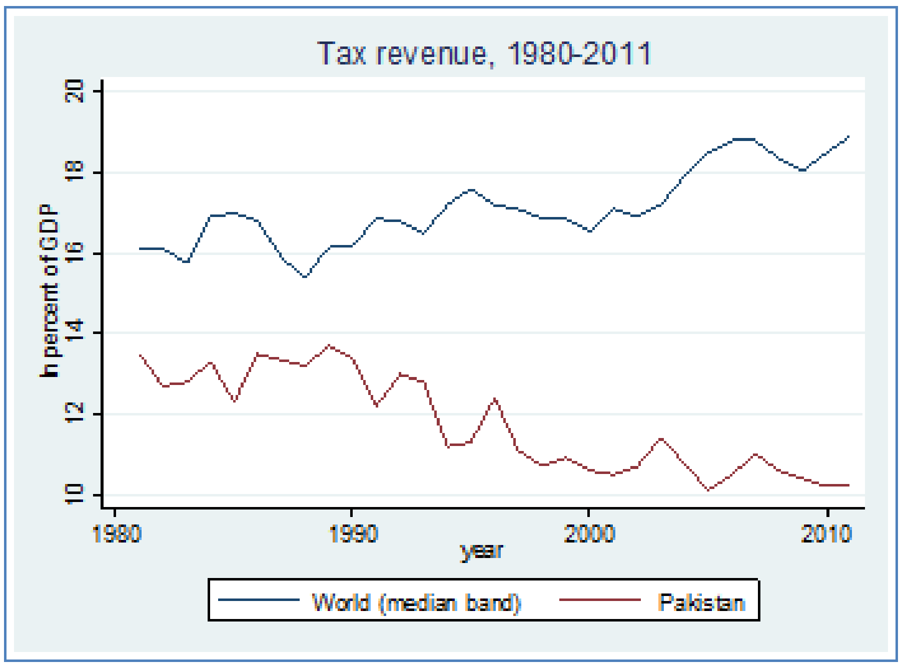


BEFORE THE PROGRAM

FISCAL SECTOR

- **Fiscal deficit has increased:**
  - The fiscal deficit has widened to over 8½ percent of GDP.
  - The tax/GDP ratio remains among the lowest in the world.
  - Domestic public debt has risen to historically high levels

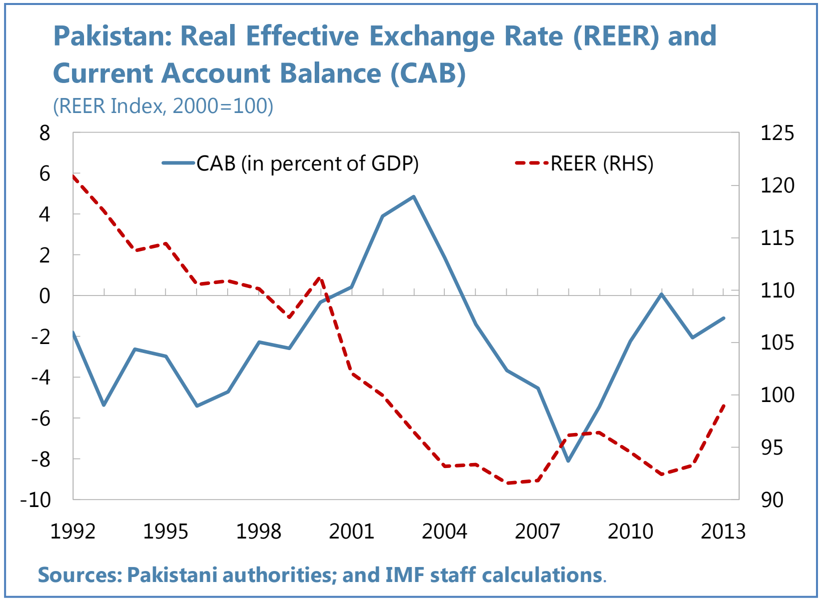


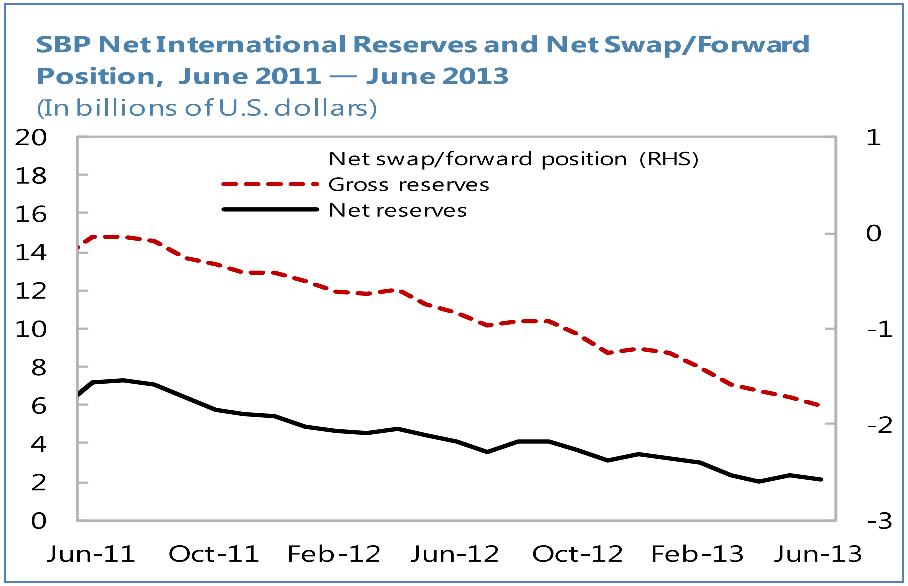


BEFORE THE PROGRAM

EXTERNAL SECTOR

- **The external position weakened significantly.**
- **State Bank of Pakistan reserves at critical levels**

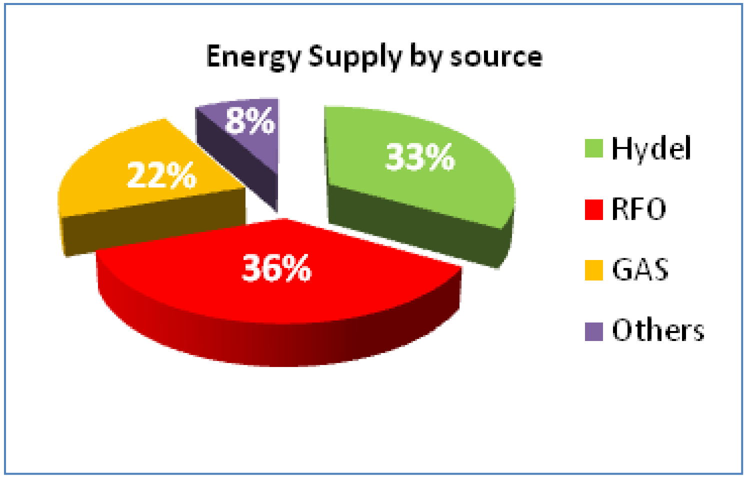


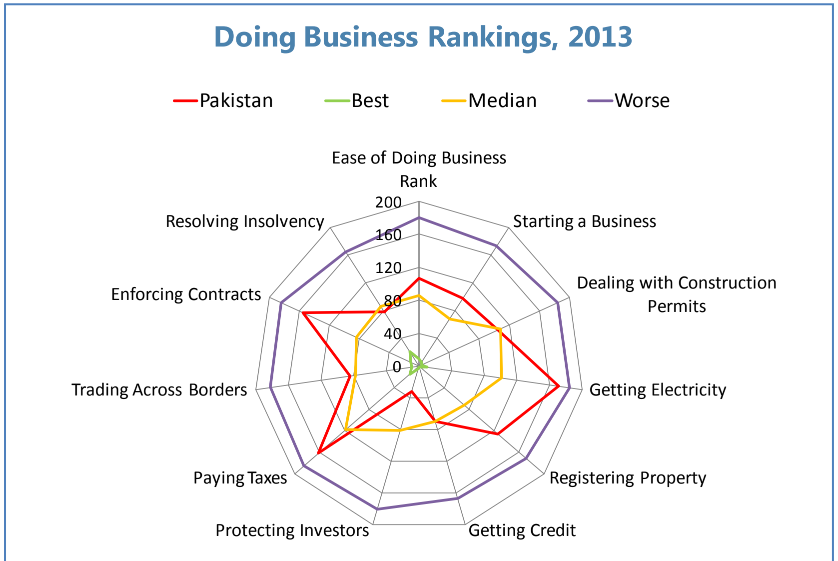


BEFORE THE PROGRAM

STRUCTURAL ISSUES

- **The energy sector has been a major drag on the economy:**
  - Unreliable energy supply, power outages of up to 10-12 hours a day.
  - Large fiscal costs, about 2 percent of GDP.
- **An Unfavorable business climate has impaired economic performance :**
  - International rankings place Pakistan low. in terms of:
    - Business climate
    - Governance





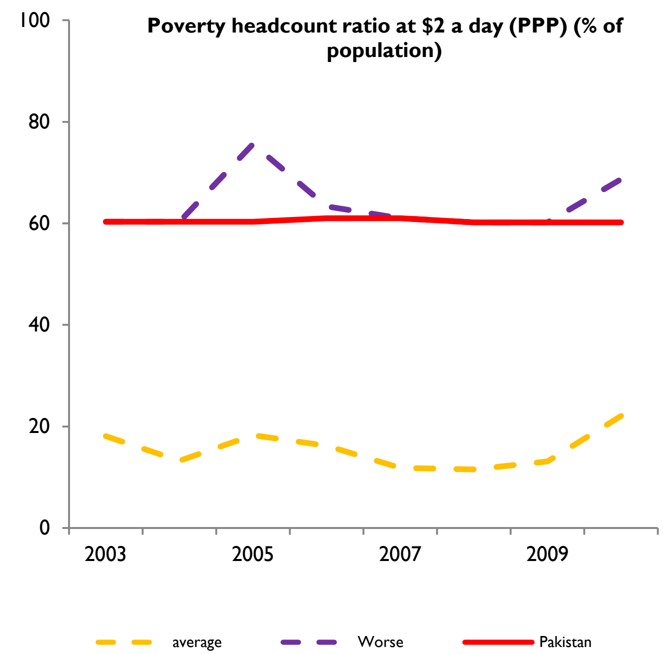
Sources: World Bank Doing Business indicators, 2013; and IMF staff calculations.

BEFORE THE PROGRAM

STRUCTURAL ISSUES

- **Poorly managed Public Sector Enterprises impair growth and worsen the fiscal balance**
  - DISCOs and GENCOs, other energy companies
  - PIA, Pakistan Railways, Pakistan Steel, etc.

- **Pakistan also lags in terms of Human Development**
  - Poverty and social support
  - Education



ADDRESSING THE PROBLEMS

A FEW LESSONS FROM THE PAST:

- Treating the macro problems without addressing the structural components has not been successful
- Strong political ownership is needed for programs to succeed.
- Social protections need to be integrated into programs
- Front-loading IMF disbursements while back-loading conditionality has contributed to incomplete IMF programs

ADDRESSING THE PROBLEMS

THE TRACK RECORD OF IMF ENGAGEMENT WITH PAKISTAN HAS BEEN MIXED

- Periodic crises ➔ repeated IMF programs
- But most programs have gone off track before completion.
- Sometimes, even partial policy gains have been reversed once crisis pressure eases.

ADDRESSING THE PROBLEMS

MONETARY AND EXCHANGE RATE POLICIES

- **Realigning Monetary Policy for Macroeconomic Stability:**
  - Rebuilding reserves to adequate levels: 3 ½ months of imports coverage by 2015/16.
  - Bringing inflation down sustainably to 6-7 percent.
  - Reducing SBP's foreign exchange swap/forward position to a sustainable level.
  - Enhancing SBP operational independence
  - Phase out government borrowing from the SBP.
  - Strengthening SBP's governance and internal controls framework
  - Allow for exchange rate flexibility

ADDRESSING THE PROBLEMS

FISCAL POLICY

- **Returning to fiscal sustainability:**
  - The fiscal deficit to be reduced from 8½ to 3½% of GDP by 2016/17.
  - Initial 2% of GDP adjustment mainly to come from revenue increase and lower energy subsidies.
  - Outer years' adjustments concentrated on broadening the tax base and reducing untargeted subsidies. (1 ppt. of GDP per year)
  - Phase out SROs granting tax exemptions or concessions
  - Improve tax administration over time.
  - Need to revisit revenue-sharing arrangements

ADDRESSING THE PROBLEMS

STRUCTURAL ISSUES

- Embarking on a comprehensive energy policy to:
  - Phasing out Tariff Differential Subsidies over the next three years.
  - Adjusting electricity prices for industrial, commercial, and bulk users.
  - Reducing subsidies on "selected consumers".
  - Rationalizing gas prices and allocating gas usage to "high yield sectors".
  - Encourage new investment in electricity and gas.
- Improving the business climate to increase domestic private and foreign investment by:
  - Setting up one-stop shop
  - Identifying the required changes in the regulations and administration to ease doing business.
  - Simplifying procedures and reducing costs for setting-up businesses.
- Leadership from World Bank, ADB, and other partners

ADDRESSING THE PROBLEMS

STRUCTURAL ISSUES

- **Structural Reforms for Fiscal Consolidation and Economic Growth:**
  - Trade policy reforms:
    - Return to something like the 2003 import tariff scheme, with 4 slabs from 0-25% rates and few exceptions.
    - Work toward normalized trade with India.
    - Take better advantage of possible trade preferences with the EU and US
  - PSE reforms:
    - Comprehensive assessment of financial conditions of firms
    - Privatize ~30-35 firms and restructure others.
    - Radical steps to address chronic problems in PIA, Pakistan Steel, Pakistan Railways.

ADDRESSING THE PROBLEMS

SOCIAL PROTECTION

- **Better targeting the poor:**
  - Widening the Benazir Income Support Program (BISP) to increase the benefit amount to protect the real purchasing power of the beneficiaries, as savings from tariff adjustments and fiscal space are realized. (World Bank, ADB, DFID, and USAID strongly involved)
  - Protecting from the direct and indirect impacts of fiscal consolidation and tariff adjustments.

THE IMF LOAN: BASIC FACTS

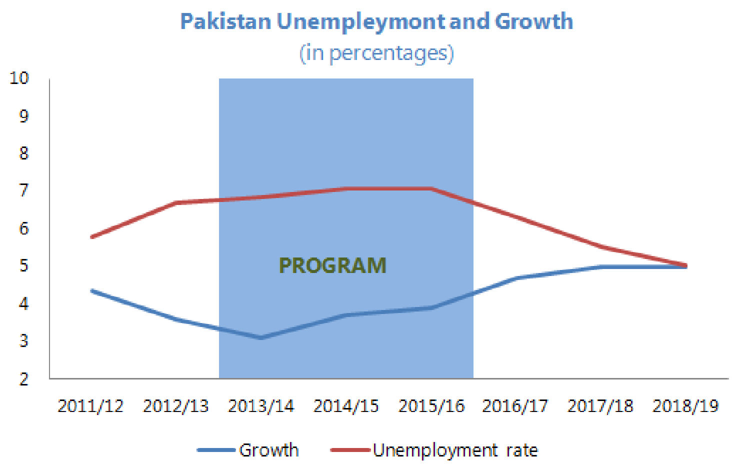
3 YEAR EXTENDED FUND FACILITY ARRANGEMENT

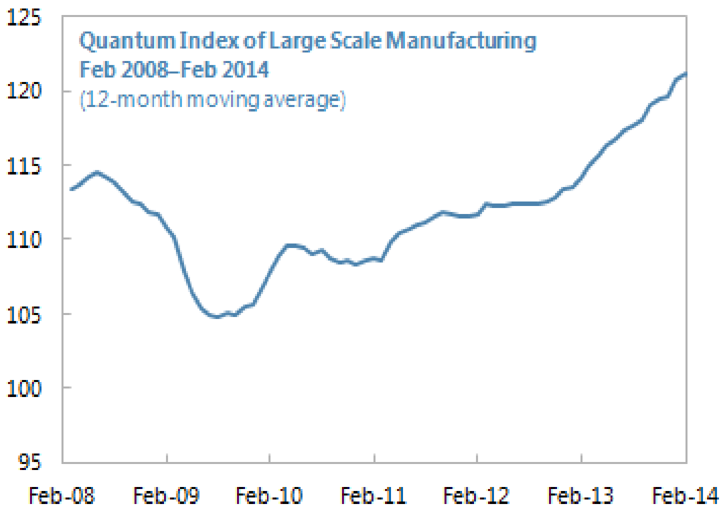
– A 36-month extended arrangement under the Extended Fund Facility (EFF)
– Total amount: SDR 4.393 billion (US$6.68 billion, 425 percent of quota),
– Approved by the Executive Board of the IMF on September 4, 2013.
– Each quarterly disbursement is worth SDR360 million (US$550 million)
– Support from other donors (World Bank, ADB, UK, US) will add another US$4-5 billion.
– Interest rate (variable) of ~3 percent; repayment over 4½-10 years.

THE PERFORMANCE SO FAR

REAL SECTOR

- **Growth has been gaining momentum:**
  - Economy expanded by 4.1% in the first half of FY2013/14
  - Large scale manufacturing grew by 5.1% during July-February this fiscal year
  - Investment is picking up as textile machinery imports rose by 52 % in dollar terms during July-March of FY2013/14 (compared to -12 % last year)
  - Going forward, growth will accelerate and unemployment will fall in the medium term





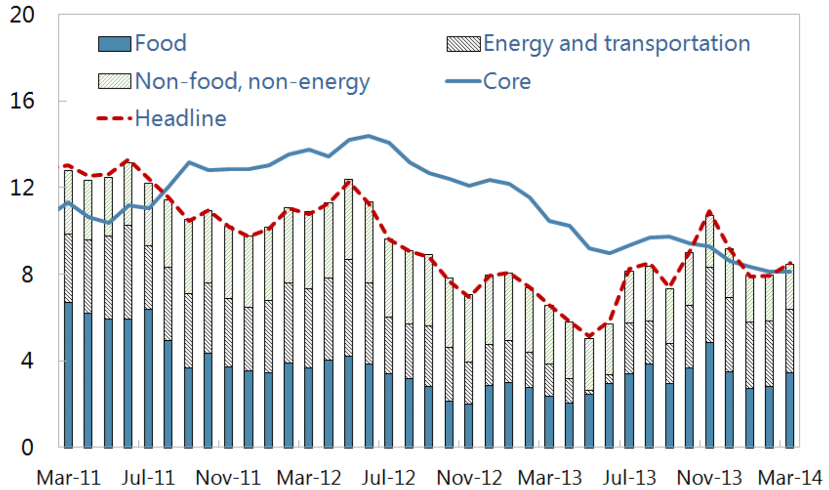
THE PERFORMANCE SO FAR

INFLATION

- **Inflation has moderated, although it remains high**
- **SBP lending to the government has been curtailed under the program, reducing inflationary pressures**

Contribution to CPI, March 2011–March 2014

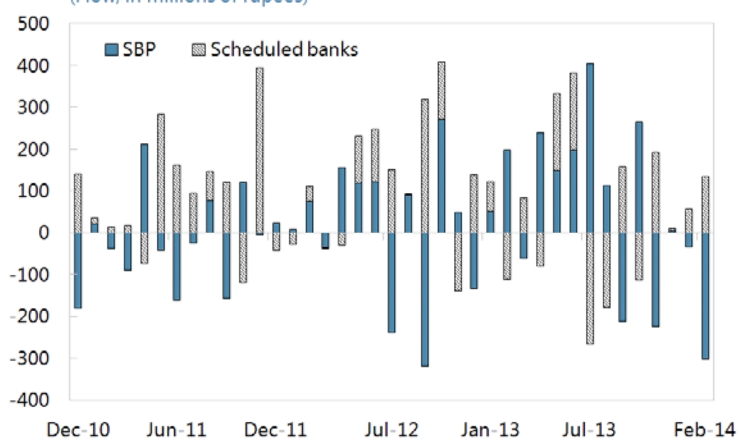
(In y–o–y precent change)



Sources: Pakistani authorities; and IMF staff calculations.

Government Borrowing from Banking System

(Flow; in millions of rupees)

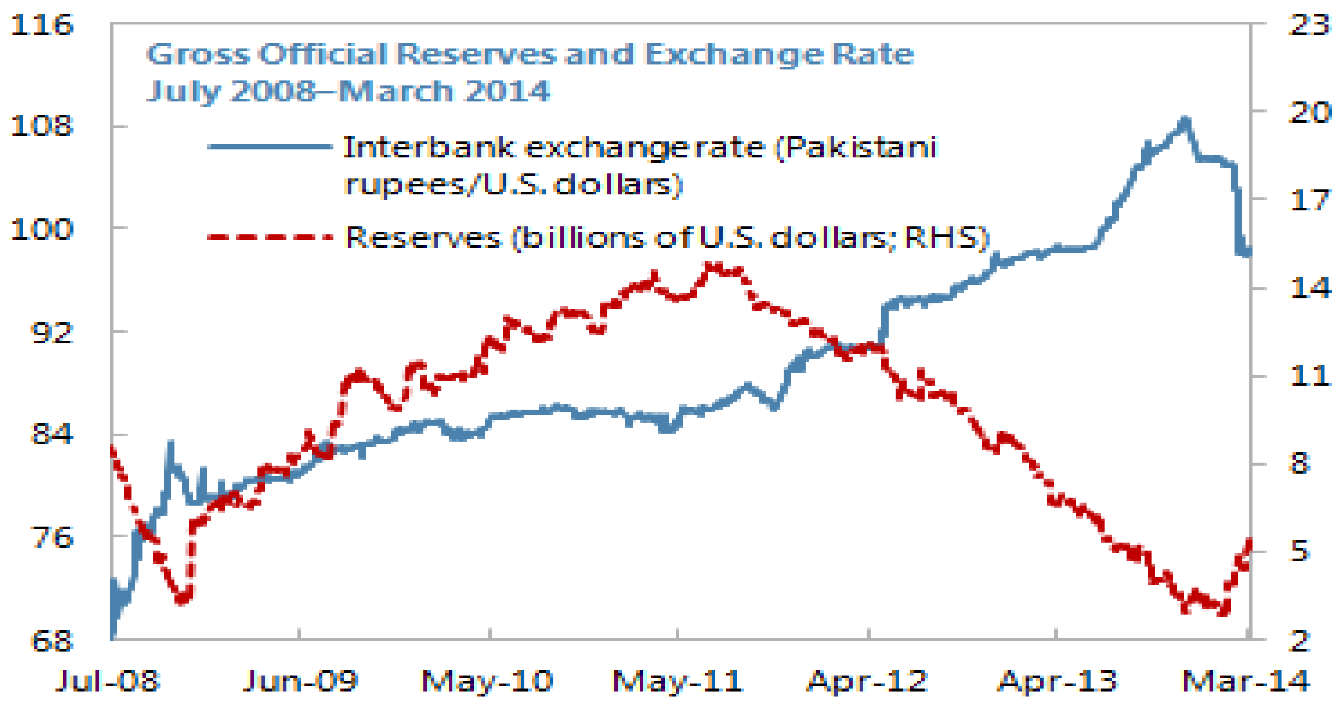


Sources: Pakistani authorities; and IMF staff calculations.

THE PERFORMANCE SO FAR

EXTERNAL SECTOR

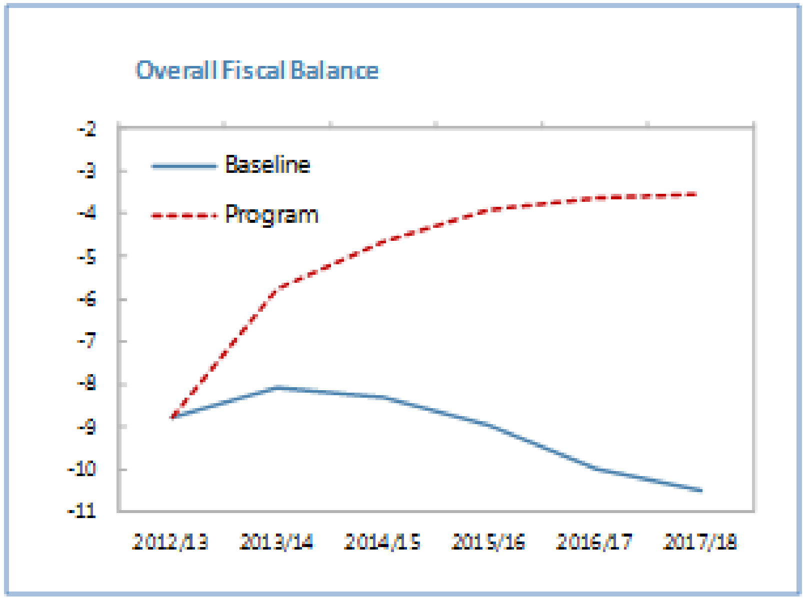
- **The SBP gross reserves have started to recover and reached US$8 billion by May 10.**
- **The PKR has appreciated by some 7% against USD during the March quarter**



THE PERFORMANCE SO FAR

FISCAL SECTOR

- **The government is on track to deliver 5½ percent of GDP:**
  - The fiscal deficit target for end-March was met by a margin.
  - This was mainly achieved by revenue growth of around 16% and subsidy reductions of around ¾% of GDP.
  - Targeted cash transfers to the poor were increased by 20% and the coverage is being expanded from 4½ million families to nearly 6 million families. No electricity price increase for lowest level consumers.
  - Medium-term debt strategy developed.



THE PERFORMANCE SO FAR

- ## ENERGY SECTOR REFORMS
  - Energy price tariff rationalization is likely to yield a reduction in subsidies amounting ¾ % of GDP this year
  - Government introduced revenue-based load-shedding and enacted amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.
  - Government hired a professional Audit firm to conduct the technical analysis of arrears in the energy sector
  - Energy company collection rates up 3%, losses down 1%
  - Energy output capacity up 700 MW; 2,000 MW by 2016

THE PERFORMANCE SO FAR

OTHER STRUCTURAL REFORMS

- Transactions advisers hired for first 3 privatizations (2 by end-June)
- Trade reform prepared to reduce from 8 to 6 tariff slabs in FY2014/15.

TARGETS GOING FORWARD

MONETARY AND EXCHANGE RATE POLICIES

- Further efforts to build SBP gross reserves, while also reducing swap/forward position
- ➔ Reserves of US$9½ billion by end-June
- Enactment of the law granting full operational independence to SBP.
- Bringing inflation down to 7½ percent in FY2014/15.
- Enactment of Deposit Protection Fund Act, the Securities Bill.

TARGETS GOING FORWARD

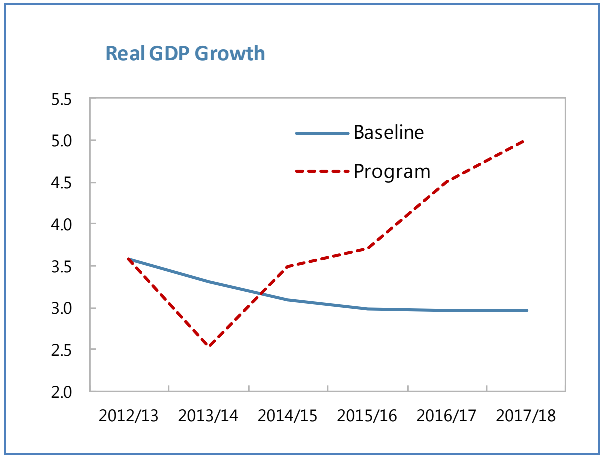
FISCAL POLICY

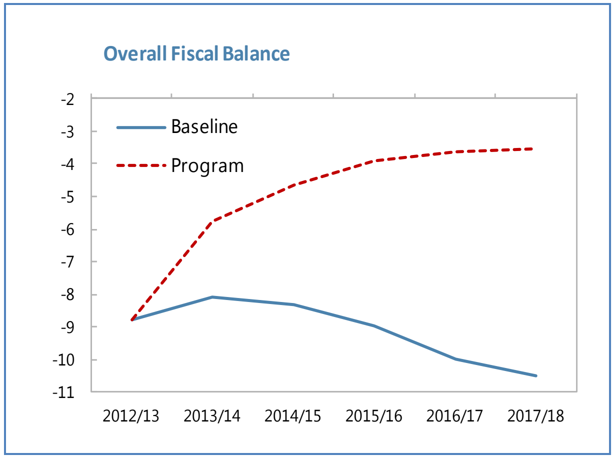
- Reduce fiscal deficit to 4.8% in FY2014/15.
- Increase the tax base by at least 0.6 percent of GDP in FY2014/15 (0.4 from SROs).
- Reduce energy subsidies by another ½ percent of GDP in FY2014/15.
- Develop a strategy to gradually eliminate the re-emergence of arrears.
- Improve the current revenue-sharing mechanisms with the provinces
- Implement the Medium-Term Debt strategy

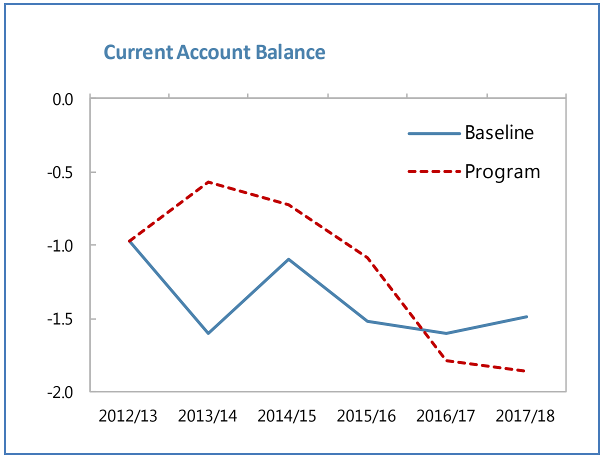
TARGETS GOING FORWARD

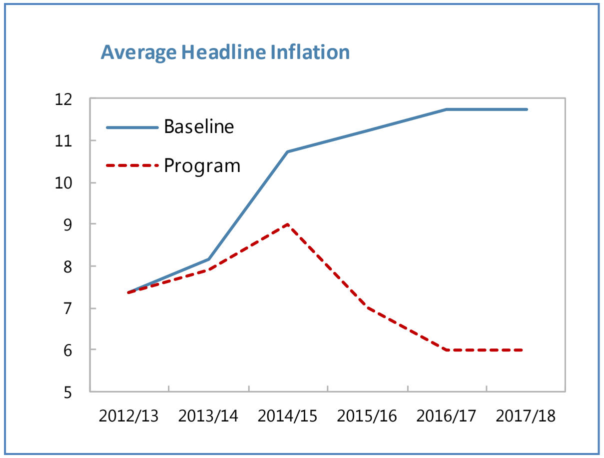
- **STRUCTURAL POLICIES**
  - Rationalize energy prices to reach cost recovery and reduce energy subsidies
  - Improve the efficiency of Energy firms
  - Privatize ~30-35 firms and restructure others.
  - Radical steps to address chronic problems in PIA, Pakistan Steel, Pakistan Railways.
  - Simplify the import tariffs and improve the business climate

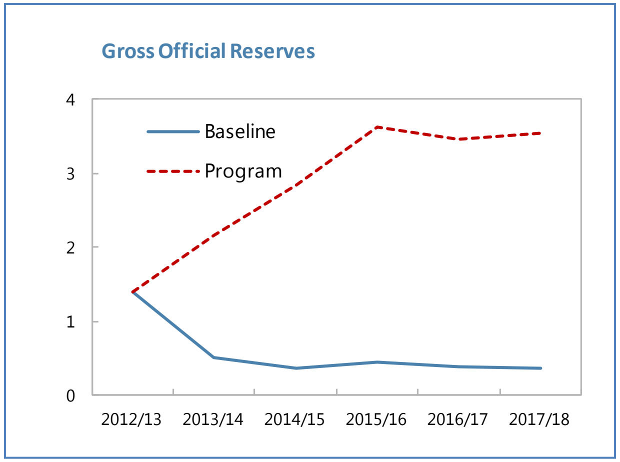
MEDIUM-TERM OBJECTIVES

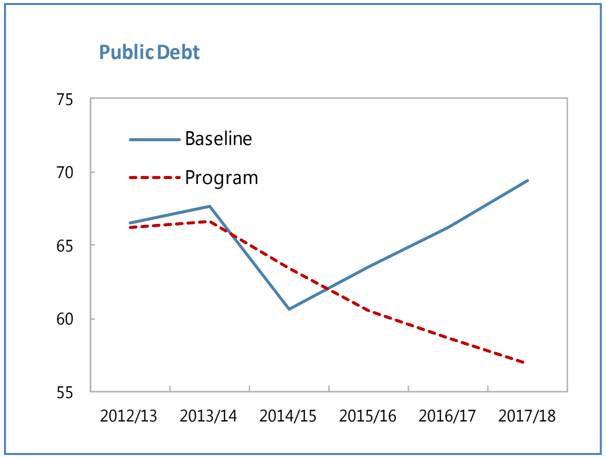












LONG-TERM GOALS:

- Periodic crisis risk permanently reduced.
- Pakistan should achieve growth rates of other Asian emerging markets on a sustained basis.
- Much higher job creation, lower unemployment.
- Significant improvement in living standards.

THANK YOU!