Rebuttal

Reference article titled "The other side of Picture: An open letter to the IMF" published in the Business Recorder dated 24-10-2016

Dr Ashfaque H.Khan, Dr Hafiz A.Pasha and Dr Salman Shah in their article titled "The other side of Picture: An open letter to the IMF" published in the Business Recorder dated 24-10-2016 have tried to present the other side of the picture on successful completion of the IMF program. They have criticised that the reform program remained a failure, which was critical for achieving higher growth, building reserves, introducing tax reforms, sustainability of external reserve position but it led to the accumulation of external debt, sought a large numbers of waivers by IMF, failure in development of direct tax system and exaggerated growth numbers etc.

In our first attempt let us respond to the criticism of waivers. There is a need for proper apprehension of a waiver. The request for a waiver is accepted only after ensuring that the dynamic criterion is fulfilled. The Fund program was not a one-off static assessment of certain outcomes. It was a three year program and in each review, the performance was assessed keeping in view the likelihood of success at the overall program level. The waiver is granted only after making sure that not only the past inefficiency has been corrected but there is a likelihood of fulfilling more stringent criteria for the following quarter.

Pakistan received a total of 15 waivers during the EFF 2013-2016 Program instead of 16 as reported in the article. The authors who remained in the Ministry of Finance are fully aware of this fact that a waiver to an unmet Quantitative Performance Criteria (QPC) is granted by the Executive Board of the IMF when it is satisfied that the loan program will be successfully implemented despite the current inability to meet the agreed upon QPC. Waivers are granted when the deviation in the QPC is minor or temporary, or when the Country's Authorities either take or promise to take corrective actions. It is worth mentioning that 66 QPCs were met over the course of the EFF program and only 15 QPCs were waived off over the course of the EFF program. Hence the percentage of Met QPCs to Waived QPCs stands at 77.28 percent.

The Fund program has now been successfully completed. It is being appreciated that present government has pulled the country out of multiple challenges and achieved macroeconomic stability over a short period of time by pursuing a comprehensive reform agenda.

With regard to the criticism on growth numbers and challenging PBS data, several clarifications have been issued. However, it is again for their information that PBS computes the National Accounts according to well stated and publically shared parameters. The methodology is based on the System of National Accounts (SNA) 2008 which provides the internationally accepted and adopted methodology. The data used to compute the GDP numbers is provided by a host of agencies, public and private as well as Federal, Provincial and local authorities. These data sources are approved by the National Accounts Committee. The data providers are members of the National Accounts Committee and verify the data provided by them. These numbers are based on hard and verifiable data.

With regard to unemployment, it is important to mention here that the Labour Force Survey (LFS) is conducted on International Standards. The LFS document is published with an overview of the main results. The micro data is provided on demand to users to do analysis. PBS mandate is to draw the empirical configuration of estimates strictly in accordance with international standards. However, the article dwells on LFS data from the researcher's perspective e.g. "reworking of unemployment rate with the addition of discouraged workers" to dramatize the assertion.

According to Labour Force Survey 2014-15, the total labour force has increased from 59.7 million in 2012-13 to 61.0 million in 2014-15. It shows that more than1.3 million people joined the labour force during this period. On the other side, the number of employed labour force increased from 56.0 million to 57.4 million during this period and unemployed people decreased from 3.73 million to 3.62 million during the same period. As a result the unemployment rate has decreased from 6.2 percent in 2012-13 to 5.9 percent in 2014-15.

The government has substantially increased its development expenditure and the private investment coming to Pakistan under CPEC will create numerous job opportunities in various sectors. In addition, a number of PM's programs such as: - Prime Minister Youth Business Loan Scheme, Prime Minister's Youth Skill Development Program, Prime Minister's Interest Free Loan Scheme, Prime Minister's Youth Training Program, Prime Minister's Fee Reimbursement Scheme for Students of Less Developed Areas, Prime Minister's Scheme for Provision of Laptops to Talented Students will provide an additional help in creating job opportunities.

The news article has made a false claim that foreign exchange reserves were built entirely through borrowing. It is worth mentioning here that while the external public debt has gone up by $9.59 billion during the last three years, the forex reserves of SBP have increased by $12.1 billion in the same period or by $15.3 billion when compared to February 2014 to June 2016. Further, present government has repaid around $12 billion of external debt till end June 2016, related to the borrowings of the previous governments. Despite these heavy repayments, the foreign exchange reserves of the country have risen to more than $23 billion, of which SBP reserves were $18.1 billion at end June 2016. The amount is equal to over five months of import-cover as compared to less than around 3 weeks of import-cover in February 2014 when the SBP reserves stood at $2.8 billion. Moreover, apart from repayments, current account deficit was also met for the past 3 years while maintaining growth of foreign exchange reserves. A healthy balance of foreign exchange reserves acts as cash buffer while helping to boost investors' confidence.

The article further claims that public debt to GDP has risen. The analysis of public debt to GDP ratio during the last 15 years reveals that in the period of high inflation, public debt to GDP ratio remains relatively better as the denominator becomes larger and this ratio mostly hovered close to 60 percent even when real GDP growth was merely half of what it is at present e.g. 2008-09. While higher inflation could help reducing the public debt-to-GDP ratio yet it has other repercussions for the economy. Therefore, economic managers would always prefer high real GDP growth coupled with low inflation rather than low real GDP growth coupled with high inflation.

The news item also incorrectly states the external financing requirement of over 5 percent of GDP at present. In fact, IMF's recent debt sustainability analysis shows that external debt would remain on a downward trend over the medium term, with the peak in external financing needs under the most stressed scenario (3.7 percent of GDP) staying well below the risk assessment benchmark of 5 percent of GDP. Further, credit rating agencies in their recent reports acknowledged this fact that Pakistan's external debt is on sustainable path and there is very little exposure to medium term vulnerabilities.

The news item incorrectly portrays that Pakistan has been forced to float relatively high cost bonds after the end of the IMF program which is totally baseless. The issuance of Islamic sukuk bonds was already part of budget 2016-17 and that too were raised at a historic low rate of 5.5 percent which is better than recent sovereign issuance of bonds by both Bahrain and Sri Lanka, the credit ratings of which are higher than Pakistan. The issuance of sukuk will equally reduce the domestic public debt by around Rs 104.5 billion and will, therefore, not result in any increase in the country's overall public debt.

The news item is an attempt to belittle the efforts put in by the government which have been appreciated at several forums. Recently, government has made amendments in Fiscal Responsibility & Debt Limitation Act to provide better operational guidance for fiscal policymaking and to safeguard debt sustainability over the medium term by imposing a limit on the federal government budget deficit by 4 percent of GDP excluding foreign grants for 2017/18-2019/20, and 3½ percent of GDP thereafter; and bringing down the public debt to GDP ratio to 60 percent until 2017/18, and thereafter adopting a 15-year transition path towards bringing public debt to GDP to 50 percent. With these targets, fiscal policy will be managed in a prudent way, leading to additional gradual consolidation and strengthening long-term debt sustainability.

Regarding continuous fall in exports, it is important to understand that the government is making serious efforts to address the issue of declining exports. It may be noted that Pakistan's major trading partners; USA, China, EU witnessed a sluggish economic growth. Our major share of exports goes to US, China and EU. The slow growth in China and EU and weak demand has also impacted Pakistan's exports' growth. However, the government is fully cognizant of this issue and taking a number of measures to increase exports. Strategic Trade Policy Framework (STPF) 2015-18 for export promotion is a welcome development which will enhance exports in future. The STPF 2015-18 includes plans to enhance Pakistan's export competitiveness by way of initiatives relating to product diversification, value addition, trade facilitation and enhanced market access. The new trade policy set the target of US$ 35 billion of exports.

With regard to writer's criticism on fiscal sector such as allowing for large statistical discrepancy, exaggerating the size of the provincial cash surplus and Federal non tax revenues. It is important to mention first that according to international standards and procedures, the statistical discrepancy also called errors and omissions, may exist in every report while comparing two sets of independent data. While comparing the data of two independent agencies relating to fiscal operations i.e. above the line and below the line, there remains always a difference which is reflected as statistical discrepancy. Basically this difference is a result of book keeping and bank statement. The international monitoring standards suggest that deficit have to be calculated through bank statement. These balances are real time numbers affecting the cash position of an organization or country. Statistical discrepancy may be positive or negative, which are based on facts being reflected in the bank statements. Not only in Pakistan but across the world, details of fiscal operations of any country contain statistical discrepancy or errors and omissions.

According to international principles and standards, fiscal deficit is measured through below the line financing items. Figures relating to financing of the deficit are cash based which are maintained on daily basis by SBP and include domestic financing and external financing. The inflows/outflows on this account are accounted for by the SBP on daily basis. The net result of these transactions is recorded as fiscal deficit on actual cash basis. The difference between budget balance calculated from book balance and the deficit balance as recorded by SBP on cash basis is reflected as statistical discrepancy. SBP is an independent body, debt stock numbers (domestic and external) are compiled by SBP based on daily transactions on this account. The outstanding debt stock (domestic and external) is available on the SBP website.

With regard to provincial surplus, the author has stated that provincial governments were unable to give surplus due to the reason that budgeted revenue was not transferred to them. In this connection it is clarified that the provincial surplus was worked out based on the revised revenue numbers which also fell short during the previous financial year.

Provincial cash surpluses are a reflection of prudent fiscal management by provinces. The use of these surpluses in reducing consolidated fiscal deficit needs to be seen in a positive light as their contribution towards meeting the national fiscal deficit objective.

During year 2015-16, an amount of Rs.703 billion was collected as federal non tax revenue receipts as against Rs.850 billion for the year 2014-15. The main reasons are; shortfall in receipts from Coalition Support Fund (CSF) and SBP profits. During the last financial year it was expected that a tranche of around US$ 400 million would be received at the end of financial year but it did not materialize. While SBP profits were also low due to the reason that during current financial year privatization receipts from banking sector were not received. Further, receipts from oil sector were also low owing to lower oil prices in the international market. However, decrease in federal non tax revenue was compensated through rationalization in current expenditure which is only 4% higher than last year.

Some of the writers' assertions regarding the power sector are not based on accurate data, it requires further clarification. The important reforms carried out by the present Government in the power sector are highlighted in the ensuing paragraphs, to correct the authors' misperceptions;

- Implementation of National Power Policy 2013 has pushed forward the structural reforms agenda in the power sector. In an effort to move to full cost recovery, the current government has rationalized tariffs. The timely payment of tariff differential subsidy (TDS) is being ensured on monthly basis. The gap between GoP notified tariff and NEPRA determined tariff has narrowed to Rs. 0.88 per unit in FY 2014-15 in comparison to Rs. 2.29 per unit in FY 2013-14, which has resulted in rationalization of untargeted subsidies. The vulnerable consumers in the residential and agriculture categories have been protected.

- Significant efforts are being made to ensure financial sustainability of the system. A Circular Debt Capping Plan has been finalized to effectively manage the power sector financial flows, stocks and subsidy budget. Mechanism of at source deduction is being implemented for clearance of outstanding receivables from Government Departments and a feeder to feeder monitoring to curtail losses is being pursued. Operationalization of Central Power Purchase Authority (CPPA) as an effective financial manager of the system is a significant step in power sector reforms. Revenue based load management is being carried out in order to ensure smooth recovery of payables. In addition, three distribution companies (IESCO, LESCO and FESCO) have been issued multi-year tariff determination by NEPRA. New Electricity Act will help improve litigation mechanism for power sector receivables.

- The implementation of above mentioned reform measures in the power sector have resulted in improvement in the transmission losses and recoveries. The latest available data for FY 2015-16 shows that transmission and distribution losses during this period stood at 17.9 percent, down from 18.7 percent in FY 2014-15. Similarly, bill collections during the FY 2015-16 stood at 94.6 percent, up from 89.2 percent during FY 2014-15. These improvements in the sector have directly resulted in reduction in load shedding, improved financial flows and fall in tariff differential subsidy, which has been on a persistently declining trend over the last three years.

- It is pertinent to point out that improvements with regard to load shedding have been acknowledged by the independent sector regulator(NEPRA) in the foreword of its State of Industry Report. The foreword of the Report states; ‘It is noted that due to better load management policies, fewer agitations and protests were witnessed during 2014-15, especially in the later part of the year. Not only, improvement in uninterrupted supply to the industrial sector has been ensured, load shedding in the domestic and commercial sectors remained somewhat predictable whereas unscheduled load shedding hours have been considerably reduced. The improved continued electricity supply to the industrial sector is expected to help increase the industrial production besides creating more employment opportunities’.

- The notion that the present government has increased electricity tariffs by 40 percent is a misrepresentation of facts. In this regard, it is important to point out that electricity tariff is determined by National Electric Power Authority (NEPRA) and the government adds tariff differential subsidies to the NEPRA Determined Tariff before notification. The Government has moved towards cost reflective tariffs and rationalized subsidies in order to focus on the vulnerable domestic segments of the consumer’s consuming up to 300 units. The government since 2013 has not increased any tariffs in the domestic categories consuming up to 300 units which accounts for 80 percent of total domestic consumption and 37 percent of total electricity consumption in the country. The tariff for agriculture consumers has been notified at a discount and held constant for Rs. 10.35 /unit for the past two fiscal years, lower than NEPRA determined tariff.

- With regard to the authors’ assertion that tariffs have been increased at a time when international fuel costs have fallen by nearly 50 percent, it is pertinent to point out that changes in fuel prices are completely passed to the end-consumers in their monthly electricity bills as determined by NEPRA, under the head of ‘fuel price adjustment’.

- With reference to the issue of circular debt (CD), it is pertinent to point out that the build-up of circular debt has also slowed down due to above outlined measures. It is expected that with implementation of laid down actions in the CD Capping Plan, the build up of CD will be further arrested and will be reduced to negligible amounts over the next few years. The outstanding stock of circular debt stands at around Rs. 321 billion (around 1 percent of GDP) as of end June 2016, excluding the liabilities of Power Holdings Private Limited (PHPL) amounting to Rs. 335b and not Rs. 630 billion as stated. The amount parked in PHCL is being fully serviced as part of the tariff and the government will ensure that principal amount is reduced through disinvestment proceeds. Thus, the Rs. 335 billion is not part of CD.

- Regarding the statement about the ‘electricity consumption per industrial consumer’ falling in 9 out of 10 DISCOs, it is important to emphasize that sales to industrial consumers increased by 13.4 percent from 18.63 billion units in FY 2012-13 to 21.5 billion units in FY 2015-16.

- The above mentioned facts clearly indicate the important structural reforms that have been implemented over the past three years in the power sector and the positive gains that have been made to date.

With regard to tax reforms, following are the main postulates relating to FBR discussed in the news piece. Growth in collection due to enhancement in tax rates and not by broadening of tax base, Lack of development of Direct Taxes, Holding Back Refunds over Rs.200 billion and FBR Tax revenue growth plummeted.

It is clarified that the revenue growth of 20.2 percent attained during FY 2016 and similar growth rates during past two years is attributed to the economic vision of the present government, policy and administrative reforms program, and diligent efforts of FBR. The FBR has taken a number of initiatives in recent years with the aim to improve service delivery, enhance resource mobilization efforts with the aim to increase tax-to-GDP ratio to 15 percent in the next few years. Following measures helped enable the revenue organization to enhance revenues substantially;

- Powers of FBR to issue SROs withdrawn (SROs/concessions have been withdrawn during last three years
- Broadening of Tax base
- Roll-out of automated system of processing of domestic taxes
- Roll-out of WeBoc for automated clearance of imports
- Computerized Risk-based Evaluation of Sales Tax (CREST) for risk based analysis of sales tax returns
- Rationalization of Import Tariff
- Rationalization of corporate Tax Rates (35% in TY 2013 to 31% in TY 2017)

- Differential Taxation for filers and non-filers
- Strengthening Tax Audit

- Queue Management System in Refunds (Abusive system of processing and payment of refunds has been improved through Queue management for refund claims (first in first out) both at field formations and FBR headquarters level

These reforms have started paying dividends in shape of improved compliance, higher revenue growth and enhanced tax-GDP ratio in recent years. The collection improved significantly from Rs. 1,946 billion (FY 2012-13) to Rs. 3,112 billion (FY 2015-16), registering 60 percent growth. The collection set a record of increasing Rs. 522 billion in a single year. FBR's tax-GDP ratio has also been enhanced from 8.7 percent to 10.5 percent (from FY 2012-13 to 2015-16). It is also pertinent to mention that during fiscal year 2015-16 the revenue target was not revised downward contrary to the past practice of multiple downward revisions. The target of Rs. 3,104 billion was surpassed by around Rs.8 billion.

The authors have further claimed that tax base has not been broadened. In this regard it is heartening to note that FBR has taken several initiatives for broadening of tax base. More than 465,000 notices have been issued during three years. Number of filers has also been increased from around 700,000 to more than 1 million (from FY 2012-13 to 2015-16).

Author's claim regarding the lack of development of direct tax is baseless. The present government has taken serious measures to increase the share of revenue from direct taxes to bring equity and fairness in the system and to encourage progressive taxation instead of regressive taxation. In order to reduce the incidence of indirect taxes, the maximum statutory rate of customs duty has been decreased from 30 percent to 20 percent in the last few years. The tax base of FED contracted over the years and now it is restricted to only few commodities like cigarettes, cement, beverages, international travel etc.

Moreover, over a period of time, sales tax has been restructured as a tax on consumption which is in line with the principle of equity and progressivity. The contention that government is not taxing the elite is not based on true perception of the tax laws. The factual position is that the current rate structure of direct taxes is based on the philosophy that you pay more as you earn more. The government has recently imposed super tax which is a direct tax on elite. Here are some examples of the adjustable withholding taxes imposed on the richest of the rich during couple of years;

- 235A. On domestic electricity bills exceeding Rs.75, 000/ per month.
- 236B. Advance tax on purchase of air ticket
- 236C. Advance Tax on sale or transfer of immovable Property
- 236D. Advance tax on functions and gatherings
- 236I. Collection of advance tax by educational institutions on annual fee exceeding Rs.200, 000/.

- 236K. Advance tax on purchase or transfer of immovable property
- 236L. Advance tax on purchase of international air ticket
- 236M. Bonus shares issued by companies quoted on stock exchange
- 236N. Bonus shares issued by companies not quoted on stock exchange

Resultant to such policy measures over the years the share of direct taxes has increased from 18.0 percent in 1990-91 to 39.1 percent, while share of indirect taxes has reduced from 82.0 percent in 1990-91 to 60.9 percent in 2015-16.

The FBR is trying to promote tax culture and taxpayer friendly environment in the country. It facilitates the taxpayers/refund claimants through speedy clearance of refunds. Overall tax refund claims have declined. The net revenue collection during 2012-13 was Rs. 1946 billion and the pending refund claims were 9.5% of net collection. This percentage has declined during the last three years and the net collection as on 30th June 2016 was Rs. 3112 billion whereas, the pending refund claims were 6.7% of the net collection.

Despite the fact that Authors claim that they have been working with Ministry of Finance they are unaware of the facts, hence their claim is baseless about the revenue growth. Contrary to their claim the tax collection has grown substantially during last three years. In FY 2012-13, the revenue collection was just Rs. 1,946 billion and the collection crossed three trillion mark i.e. Rs.3.1 trillion in FY 2015-16. The collection in this short span of time grew by more than 60 percent and in absolute terms an addition of Rs.1.2 trillion has been made.

Pakistan is not what it was three years ago, the country is more stable and the international investors see Pakistan as new destination for their investments. The present government is focused on implementation of reform agenda for a better and strong, equitable, sustainable and inclusive growth.