Policy Research Institute of Market Economy

PML-N ECONOMIC AGENDA

BETWEEN PROMISES & PERFORMANCE



SUPPORTED BY

Center for International Private Enterprise

PML-N Economic Agenda:
between Promises and Performance

Policy Research Institute of Market Economy (PRIME) is a public policy think tank striving for an open, free and prosperous Pakistan by writing, networking and campaigning for economic freedom.

The report titled “PML-N Economic Agenda: between Promises and Performance” analyzes the economic performance of PML-N over the past five years, based on a series of 10 reports under PRIME’s Government Policy Scorecard Project. The main themes discussed are Energy Security, Tax Administration, International Trade, Public Debt and State Owned Enterprises.

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Objective and Scope

The objective of the report titled "PML-N Economic Agenda: between Promises and Performance" is to analyze the economic performance of PML-N over the past five years, based on a series of 10 reports under PRIME's Government Policy Scorecard Project. The scope of this report is mostly confined to the performance over the governments' tenure, based on the agenda targets, wherever applicable.

The performance analysis is further broken down to five major categories, namely: Tax Administration, International Trade, Public Debt, Energy, and State Owned Enterprises. This report has analyzed these five categories with respect to agenda targets, reforms or the lack thereof, and any other key issues surrounding the sector.

The annexure at the end of the report aims at critically evaluating and commenting on specific agenda targets, in the light of PRIME's tracking scores. Each category is covered as a different chapter, entailing performance overview, major achievements, bottlenecks and recommendations for reforms' sake.

Executive Summary

PRIME's 10th and last tracking report on PML-N Economic Performance was subtitled "Light at the End of the Tunnel." An overall score of 6.3 out of a possible 10 was given to the government's economic performance. There is little denying the fact that the economic performance today is much improved from 2013, when the government took charge.

The economy has gradually found a growth trajectory that appears sustainable. The target of keeping inflation under control has also been well achieved, however much it may be a factor of external variables. Having said that, some structural economic issues remain unaddressed to date, and some indicators have worsened, in the post tracking period. High fiscal slippage, falling reserves, and piling debt are concerns that could potentially undo all the good work done in the past five years.

Of most critical importance to the government's agenda, vision, and achievement is the energy sector. The score of 6.73 in the 'Energy Security' category appears to be on the higher side and seems a casualty of limited scope of score calculation.

Other than one major achievement of ensuring enough power generation, most other critical components of the power sector, either remain unaddressed or have worsened. The dismal performance of DISCOs and GENCOs, and the inability to privatize stand out, and could possibly cause more trouble than previously. Achieving ample generation capacity is no mean achievement, but the interconnectivity of the sector is such, that it will not work in isolation. Energy security will never be achieved without energy affordability and structural reforms.

On taxation reforms, the performance was far from satisfactory, with a score of 2.93. The long-standing issues of expanding the tax net, broadening the base, taxing all income, reforming the FBR, ensuring compliance, rationalizing rates, by and large, remain unchanged. Tax collection has undoubtedly improved in absolute terms, but that is a result of increased size of economy. Taxation reforms, on the whole, are still found wanting.

The "international trade" category saw mixed results, with a marking of 4.7. The middling score mirrors the state of affairs on this front as improved macroeconomic conditions and better electricity availability, resulted in steady growth in manufacturing and private sector credit demand.

On the other hand, the trade balance has kept worsening, with less than optimal exports growth. Pakistan's regional trade barriers continue to exist and the lack of diversification and high tariffs have kept Pakistan on the lower end of most trade-related rankings.

To sum it up, PML-N can claim to have achieved two of its biggest promises of reduced load shedding and improved security situation. Both these indicators are tangible and appealing to the masses. But the devil lies in details, and that is where, the reading is far from satisfactory. There definitely is light at the end of the tunnel, but the tunnel, it appears, is a bit too long, and the light dim.

Chapter 1: ENERGY SECURITY AND AFFORDABILITY

1. Energy Security

PML-N's 2013 election agenda was largely built around the energy sector reforms, and the promise of a "Roshan Pakistan'. Within the broader ambit of energy security, 'availability' and 'affordability' were coined as key focus areas. This section attempts to analyze the reforms PML-N undertook in the energy sector, mostly surrounding, but not strictly limited to, the agenda.

1.1. Electricity Installed Capacity

The PML-N took office with the power sector in dire straits. Electricity load shedding had peaked to 12-14 hours a day across the country. Not having enough capacity to generate power is often cited as the reason for the crisis. But that was not the case. If anything, the then government had added enough megawatts to the national grid to more than account for peak demand.

The total installed capacity from FY09-FY13 increased by 17 percent, as 3392 MW were added to the grid.[1] In comparison, the net addition to installed capacity from FY13-FY17 has been 18 percent or 4190 MW. But the overall situation of power availability and system health is vastly different between the two tenures. This goes on to assert the notion that installed capacity was never the core problem.

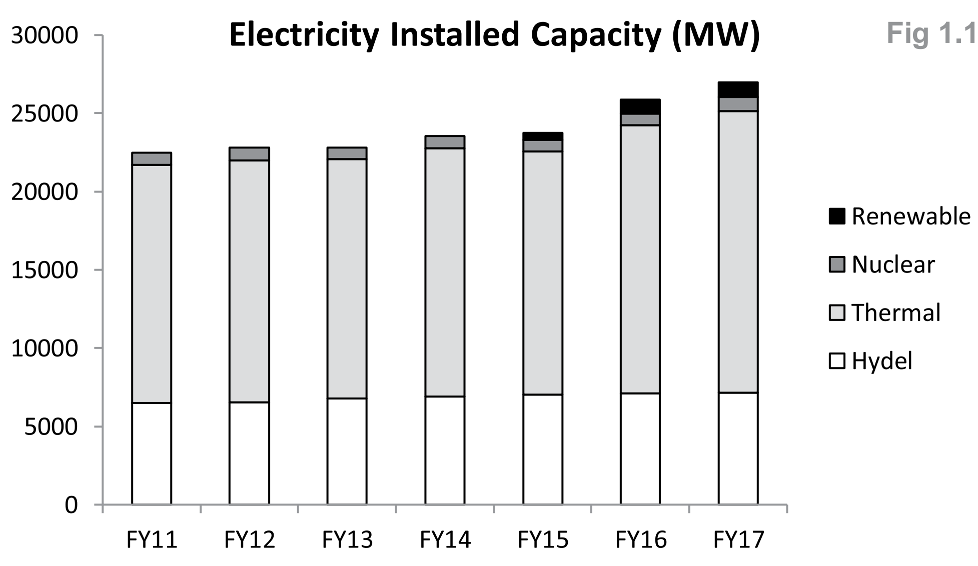


Fig 1.1

[1] *Energy Year Book(s) 2009-2013*

1.2. Electricity Generation

Much improved electricity supply, with zero load shedding for industrial consumers and much reduced load shedding for domestic consumers goes on to tell the overall system availability has considerably gone up. The power generation from FY13-FY17 has increased by 20 percent in four years.[2] The same matrix in the previous 5-year tenure showed a 5 percent growth.

It could be safely established that the capacity additions to the system have been translated more effectively into actual generation. In FY18 to date, electricity generation has improved by 13 percent over the same period last year. This is a result of over 2000 MW of power added to the system in FY18.

Pakistan is slated to surpass peak electricity demand requirement by early 2019, as more CPEC related power projects are due to commence operations. There are another 8,000-10,000 MW in the pipeline to be added by 2021, including non-CPEC projects as well.

Should things go as planned, load shedding should be a thing of the past. But the dynamics have many more variables than just generation and capacity. The government must be commended for ensuring enough power availability. But this cannot necessarily be termed as power security, unless broader issues revolving around power fuel mix, losses, tariffs, costs, recovery, governance and cohesion are also looked into.

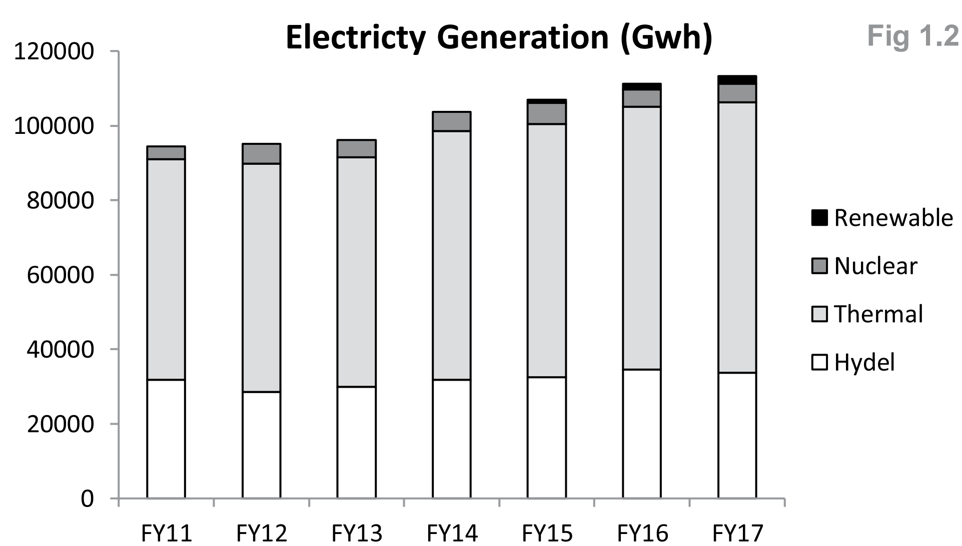


Fig 1.2

[2] *NEPRA State of The Industry Report 2016*

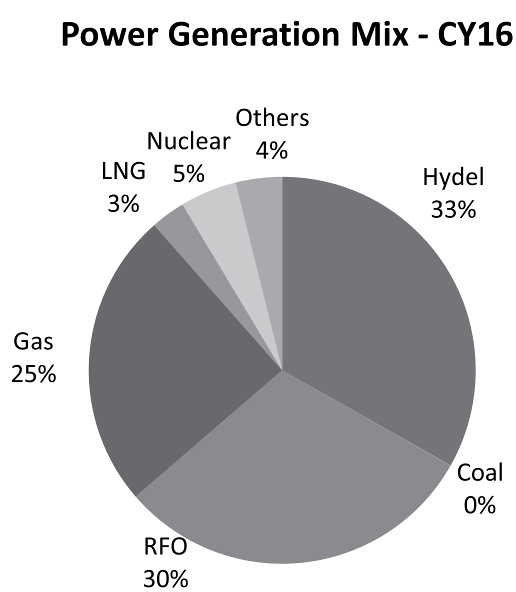
1.3. Generation Fuel Mix

Imbalanced power generation mix has long been a bane for Pakistan's power sector. It has been dominated by thermal generation for decades, and continues to date. But the shift in the right direction is visible, especially since last three years. The experts have long argued for reducing reliance on furnace oil (FO) based power generation, which was as high as 38 percent of the total generation pie in FY12.

The generation mix currently reads a much improved reading, with the share of FO based electricity generation reduced to one-fourth of the total pie. Improved natural gas supply along with the advent of power plants based on imported LNG also ensured almost one-third share in the generation pie.

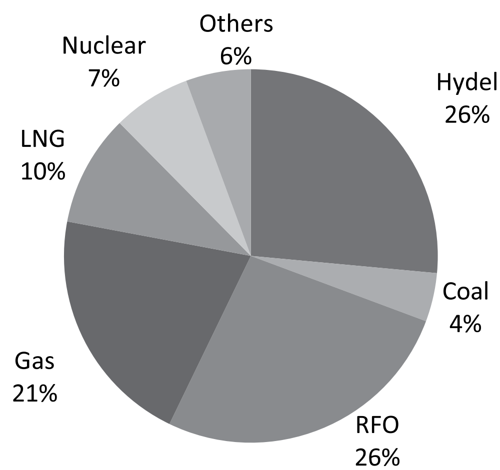
The share of coal and nuclear-based electricity is also inching up, which is a good sign. Moreover, mega hydel, local coal, and LNG plants are planned to commence operations in the next three years, which could result in a more dependable and cheaper source of power generation. The strict adherence to merit order based on fuel type cost has helped maintain a much improved generation mix.

Fig 1.3



Power Generation Mix - CY17

Fig 1.4



1.4. Distribution Sector

1.4.1.1. T&D Losses

The transmission and distribution system has continued to bleed, after a brief period of recovery. Government's plan of reducing T&D losses to less than 10 percent was always unrealistic. The losses have remained in excess of 18 percent, sliding only by 3 percentage points from FY13.[3]

Not a single DISCO (Distribution Company) has been able to meet the allowed limit by NEPRA. The overall allowed T&D limit by NEPRA in FY15 and FY16 was 15.27% and 15.23%, respectively. The actual T&D losses came in at 18.7% and 17.95%, respectively. More troubling is the fact that five out of ten DISCOs could not even meet their own requested T&D limits.

Such massive bleeding of T&D losses does not only reflect in cost and tariff mismatch, it also widens the gap between notified tariffs and actual billing. The recent surge in circular debt to over Rs700 billion[4] is also reflective of massive underperformance of the DISCOs in terms of controlling losses.

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[3] *MoWP Reform Monitoring Report March 2017*

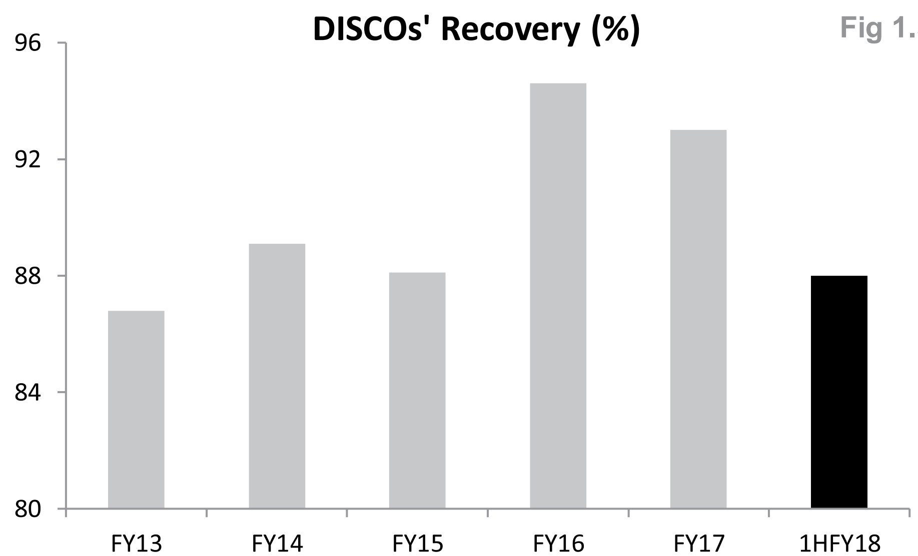
[4] *IMF Country Report on Pakistan – March 2018*

1.4.1.2. DISCOS' Recovery

The target was 100% collection on electricity billed, but it is also a factor of T&D losses. The failure to put a lid on T&D losses ensured that full recovery was not possible, because the actual losses surpassed NEPRA's allowed losses. Five out of ten DISCOS showed improvement in billing collection, while five showed more deterioration.

The collection peaked to 94.6% in FY16, but has again started to dip ever since, having gone down to 88% by the end of December 2017. Recall that the collection was at 85% at the end of FY13, which shows the situation is back to square one.

Fig 1.5



Source: Nepra

1.5. Circular Debt

The power sector receivables had stopped accumulating byFY15, after the government injected Rs480 billion, right after assuming office. The toll has now reportedly crossed Rs700 billion (including the amount parked in holding company). The root causes were never addressed, and the mismatch between actual cost and pricing of electricity led to such a massive resurgence in over two years.

The difference between actual and allowed T&D losses has also played a huge role in circular debt resurgence. The subsidies have been reduced substantially from 1.2% of GDP in FY13 to just 0.4% of GDP in FY17, but the delay in subsidy payments and continuation of inter-DISCO tariff differential subsidy have also led to the current situation.

The difference in determined and notified tariffs is another contributor to circular debt, along with delays in recovery on account of Fuel Price Adjustment (FPA), delay in GST recovery, disallowance of interest cost by NEPRA, and payment of late payment surcharge. These problems have existed long enough, but inaction suggests privatization is the best way out to at least stem the flow.

The government is again trying to deal with the situation with ad-hoc measures, such as borrowing from banks and issuing TFCs. Circular debt will continue to persist unless a major revamp of distribution and transmission sector takes place. NEPRA also needs to determine tariffs more timely, so as to limit the backlog of payments arising from the delay. Moreover, privatization of DISCOs with high losses and low recovery is of supreme importance to tackle the circular debt menace.

1.6. Privatization

Failure to privatize the DISCOs and GENCOs has caused more damage to the entire power sector reforms, than any other variable. Let alone the ailing one, the government completely failed to privatize even the better performing DISCOs and GENCOs. The result is continuation of inefficient systems, bad governance, high losses, no accountability, and high circular debt.

Expecting the government to privatize any of the companies so close to election is an exercise in futility. The government plainly lacks the technical expertise, financial space, and political will to bring about structural changes in DISCOs. The best way out is to ensure competition and provision of choice to consumers. Unbundling the distribution network into multiple companies, on a multi-seller distribution model should be the way forward

2. Energy Affordability

Electricity Tariff Structure				Fig 1.6
Rs/Kwh	**FY13**	**FY14**	**FY15**	**FY16 to date**
Residential				
Up to 50 units	2.00	2.00	2.00	2.00
01-100 units	5.79	5.79	5.79	5.79
101-200 units	-	8.11	8.11	8.11
201-300 units	8.11	12.09	12.09	10.20
301-700 units	12.33	16.00	16.00	16.00
Above 700 units	15.07	18.00	18.00	18.00
Commercial				
Less than 5 kw	14.77	18.00	18.00	18.00
Above 5 kw	9.72	16.00	16.00	16.00
Industrial				
Up to 25 kw	10.51	14.50	14.50	14.50
25-500 kw	9.14	14.00	14.00	18.00

Source: NEPRA

While energy availability has seen significant improvement over the government's tenure, the other vital cog of energy security, affordability, has not improved. Granted, that the electricity generation fuel mix has improved, from a heavy reliance on FO based thermal generation, to a more balanced and well spread mix of LNG, natural gas, coal, nuclear and FO.

This has surely resulted in savings on account of fuel component of the electricity tariffs. Lower international oil prices have also kept the fuel price component in check. End consumers have benefited on account of Fuel Charges Adjustment (FCA) by an average Rs2.5/Kwh monthly in the last two years.

But the government has been rather reluctant to notify the NEPRA determined tariffs for 2016 and 2017. The base tariffs in accordance with fuel reference price stands to be altered in revised determined tariffs, but delay in notification deprives consumers of the relief.

Moreover, continuation of various surcharges, namely Neelum-Jhelum surcharge, financing cost surcharge, and tariff rationalization surcharge, is in sharp contrast to the stated National Power Policy 2013 and Subsidy Policy Guidelines 2014.

The Neelum-Jhelum surcharge is being collected since 2008. It was initially meant to be collected for a certain period, but has been extended indefinitely. The tariff rationalization surcharge and financing cost surcharge are also included in the cost of DISCOs, over and above the revenues requirements.

This practice is a blatant case of incentivizing DISCOs to underperform. The government fails to acknowledge that the shortfall results due to the inabilities of DISCOs to recover the allowed tariff. These surcharges are an undue burden on end consumers, who end up paying for inefficiencies, priced in as costs.

It is pertinent to mention that most surcharges have been contested by NEPRA, but it has no final authority to challenge the government. In most cases, the government has been advised by the IMF and other donor agencies to impose surcharges in the name of tariff rationalization – when in fact, the real motive is to recover losses from paying consumers, and leave the real structural reforms unaddressed.

The IMF in its latest country report on Pakistan has again asked the government to consider imposing fresh surcharges on electricity tariffs. Timely tariff notification and privatization of DISCOs, would instead serve the purpose better than surcharges.

3. NEPRA Reforms

3.1. Upfront Tariff

Government had envisaged upfront tariff for wind, solar and other projects, which continued till 2016. But NEPRA has since decided to move to competitive bidding regime, on most renewable sources. The step aims to create more healthy competition, and promises to encourage and incentivize more efficient players, and best practices.

3.2. Notification of Tariff

Delay in notifying NEPRA determined tariffs has been a huge problem towards piling up of circular debt, and mismatch in generation cost determination and pricing. Government has been sitting on NEPRA's final determined tariffs for last two years, which has contributed to exceeding allocated subsidy for power sector.

Government's treatment of NEPRA determined tariffs according to what suits it, has also been a problem. NEPRA's decisions in various cases have repeatedly been disallowed and challenged by the government. This has resulted in lengthy litigation cases, and a subsequent decision always carries a chance of being implemented with retrospect, all of which comes with costs.

4. Gas Sector Reforms

4.1. Tariff Rationalization

The cross subsidy arrangements between SNGPL and SSGC have not worked, and have resulted in arrears increasing every year. Multiple delays in notifying updated gas tariffs have also contributed to the problem, as OGRA and the distribution companies are mostly found in the courts, over revenue requirement determination.

Consumer gas price in Pakistan, especially for the domestic sector is on the lower side, and encourages misuse. Nearly one-fourth of Pakistani households have natural gas connections, and the average monthly bill does not exceed Rs. 500, that includes usage of gas for water and room heating purposes. Whereas, majority of more deprived Pakistani households continue to burn wood or use LPG, which on an average costs four times more than natural gas. The disparity needs to be ended, by increasing gas prices, and reducing progressive slab volumes.

The advent of LNG now demands weighted average pricing mechanism in place, to ensure gas at market competitive rates, so as to put it in more productive industrial use, and reduce cross subsidy, and encourage conservation.

4.2. UFG Losses

System losses in natural gas have been a more pressing issue than even the electricity line losses. Both distribution companies have time and again requested for more UFG allowance, close to their actual losses, which have increased from 6.5% in 2005 to 10-11% in 2017.

Every 1% of UFG loss incorporated in the end consumer tariff contributes around Rs. 4.5 – 5 billion to the tariff. Both the companies have miserably failed to put a lid on UFG losses, despite technical and financial assistance from the likes of World Bank and the ADB. The UFG allowance has rather been moved upwards from 4.5% to 6.3%, but even that is termed insufficient by the ailing gas distribution companies.

There is a need to put an effective UFG control system in place. It has been observed that the bulk to retail ratio of gas supply has worsened over the years from 45:55 in 2003 to 25:75 in 2015. Reduced supply to bulk sector results in higher UFG losses, and increased inefficiency.

Also, the companies need to be encouraged to work on commercial considerations and be permitted fair pricing margins, instead of the current formula based on fixed assets. A 1% reduction in UFG loss results in saving of up to 50 mmcfd. Effective implementation of Gas Theft Act also needs to be in place to reduce UFG losses.

4.3. Gas Conservation

No gas must be allowed for water heating, and be instead replaced with solar heaters. The domestic sector accounts for 21% of total gas consumption, and is the most inefficient usage, at highly subsidized rates.

Government has done well to curtail the usage of natural gas in transport sector as CNG, but it still accounts for 5% of total consumption. The CNG usage should be restricted to just mass public transport projects. This would also ensure much lower UFG losses, better performing gas distribution companies, and low cross subsidy requirements.

5. Energy Reform Recommendations

i. Ministry of Energy needs to be strengthened with a National Energy Authority, comprising of sector experts, aimed at eliminating duplication of efforts, and increasing capacity building.
ii. Simple cycle power plants must be replaced with combined cycle, with a minimum of 50% efficiency.
iii. Minimum efficiency standards to be made applicable for all available appliances, to ensure conservation and efficient usage.
iv. All blanket subsidies on power, gas, and petroleum products to be replaced with targeted subsidy.
v. Privatization of DISCOs to ensure competition, by following multi-seller distribution model and unbundling of the network.
vi. Accurate determination of T&D losses to ensure full recovery and limit the circular debt growth.
vii. Improved monitory and control systems to improve bill recovery.
viii. End government interference in NEPRA and ensure no delays in notifying NEPRA determined tariffs.
ix. Follow the dispatch merit order strictly.
x. Adopt Competitive Bidding regime for all future projects, to ensure competition, and better affordability.
xi. Work on Thar coal needs to be expedited.
xii. Gas prices must be rationalized, and based on weighted average to discourage misuse.

Chapter 2: TAX ADMINISTRATION

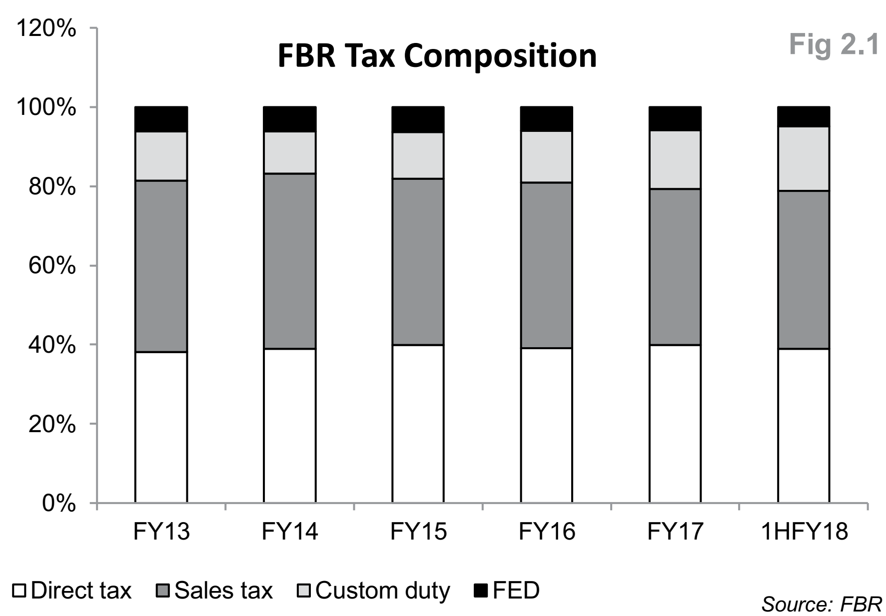
6. Tax Performance

6.1. FBR Collection &Composition

FBR's tax collection has an 85% share in total taxes, and the collection in 1HFY18 has increased by 18% YoY.[5]The tax composition has been virtually unchanged in the last five years, with direct taxes constituting 38%-40% share in total FBR taxes (see Fig 2.1). The share of indirect taxes continues to be dominated by sales tax, the share of which has dipped slightly from 43% in FY13 to 40% in 1HFY18.

FBR has consistently and comfortably missed annual tax collection targets, year after year. But this could be attributed to both unrealistic targets and some slacking on the part of FBR. The tax collection has nonetheless, seen a steady improvement, barring FY17, the YoY growth has been north of 15%.

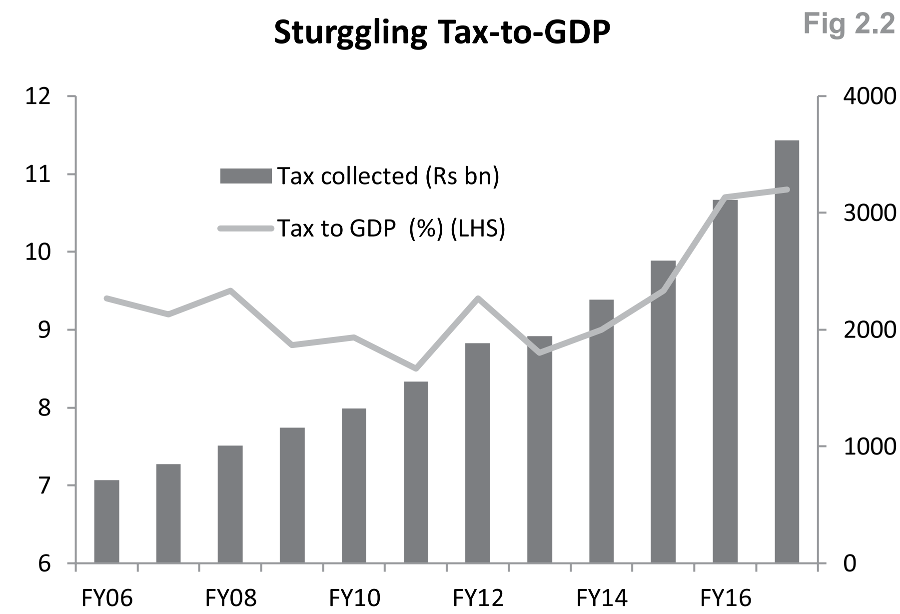
The 1HFY18 breakup shows the growth is broad based, led by a 20% YoY increase in sales tax, and 30% in custom duties. Direct taxes in 1HFY18 have soared by 15% YoY. When seen in context, the tax-to-GDP ratio was sitting at a lowly 10.8%. Yes, there has been some improvement from 9% in FY14, but the pace of growth has been rather muted, which shows why Pakistan is ranked at 172 out of 190 countries, in Paying Taxes ranking.[6]



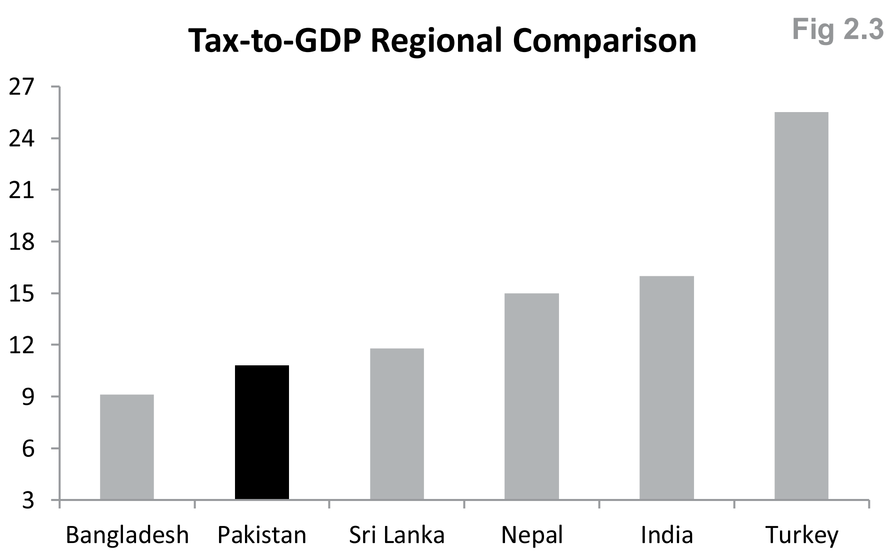
Source: FBR

[5] *Pakistan Fiscal Operations Jul-Dec 2017, Ministry of Finance*

[6] *Doing Business Report(s), World Bank*



Source: SBP State of the Economy - 2017



Source: SBP State of the Economy - 2017

6.2. Tax Base

Pakistan's tax base has been continuously reading a sorry state, showing near stagnation. Pakistan has a grand sum of 1.31 million active taxpayers, according to the latest FBR list[7]. This number has gone up from 1.14 million tax filers in FY16, and 0.75 million in FY13, which is a decent growth. But there is more to it than what meets the eye, and a closer examination of income taxpayers list and FBR Tax Directory marks the fault lines.

Of the 72,500 companies registered with the Securities and Exchange Commission of Pakistan (SECP), only 43% deem it necessary to file tax returns.[8] Number of registered companies filing tax returns has increased from 39% in FY13 to 43% in FY16. What is important to note is that almost half the tax filing companies, pay zero in taxes, inching up from 44% in FY13.[9] The number of companies, filing tax returns, increased by 11% YoY in FY16, of which, 68% paid zero tax. Such skewed is the tax base amongst companies, that 96% of taxes are contributed by 7.6% of all filing companies. A sizeable sum of companies also goes missing each year from the filing list, which should be a cause of concern for FBR.

The case with Association of Persons (AOP) is not much different. A little over 48,000 AOPs filed returns in FY16 – with a growth of just 8.6% YoY. The number of AOPs leaving the system was more than the additional AOPs filing taxes, leading to a net reduction in tax filers.

The staggeringly low number of filing AOPs should be an eye-opener, as in India, one-third of AOPs are filers. The number of AOPs in Pakistan is not official, but crude estimate put it around 0.5 million, which gives a 10% tax filing rate for AOPs. For a sector, with ever increasing share in GDP, bank deposits, and borrowings – yearly collection of Rs. 53 billion (less than 2% of total FBR taxes) is pittance.

6.3. Regressive Taxation

Pakistan's reliance on indirect taxes is well documented. The relative lack of success in roping in all those liable to pay taxes has increased dependence on indirect taxes, which have averaged 60% of total FBR taxes in the last 5 years.

Sales tax constitutes nearly three-fourth of all indirect taxes, and two-fifth of all FBR taxes. During 1HFY18, sales tax collection increased by 20% YoY, much in line with 5-year average growth. Petroleum products constitute more than 50% of sales tax

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[7] *Active taxpayers List (March 2018), FBR*
[8] *FBR Tax Directory 2016*
[9] *https://www.brecorder.com/2017/08/16/365006/tax-directory-found-wanting/*

collection, and remain a handy tool with the government to adjust fiscal slippages, if and when needed.

Surge in imports, especially those in the automobile sector in 1HFY18, contributed to 30% YoY rise in custom duties. The imposition of high regulatory duties on non-essential imports of late may result in subdued collection from custom duties with a lag.

The elephant in the room is the increasing share of regressive taxes in direct taxes. The share of withholding taxes (WHT) in direct tax has spiraled from 58% in FY13 to 70% in FY17.[10](See Fig 2.4). On the other hand, the growth in on-demand collection and voluntary payments has slowed down considerably, despite the efforts aimed at bringing more filers to the tax net.

WHT is regressive in nature and overdependence on such an avenue for direct taxes, is far from ideal. Heavy reliance on WHT has adverse implications for the low-income segment. Furthermore, the practice of having differential rates for filers and non-filers, however, well-intended it may have been, has failed to produce the desired results.

The impact of WHT on banking transactions has been counterproductive, with a contribution of less than 1 percent to FBR's tax revenue. The step has resulted in increased number of filers (mostly in the salaried class who already get tax deducted at source), but it has given birth to undesirable increase in currency-in-circulation (CIC). (See Fig 2.5)

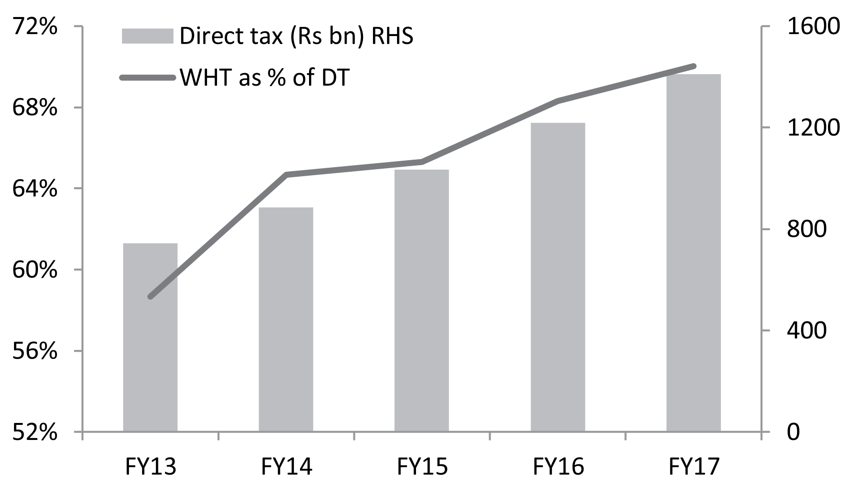
The record high money supply growth also coincided with slowdown in deposits growth. The share of private sector deposits in total deposits went down from 28% before WHT imposition on banking transactions, to 25%, after the imposition.

Almost negligible revenue impact, and rise in cash economy, both indicate that the WHT imposition on banking transactions failed to meet its objective. In fact, what has resulted is the anti-thesis of the objective. Continuation and increasing reliance on such presumptive tax measures is an admission of failure to widen the tax net and broaden its scope.

[10] *SBP State of the Economy 2017*

The "Indirect" in Direct Tax

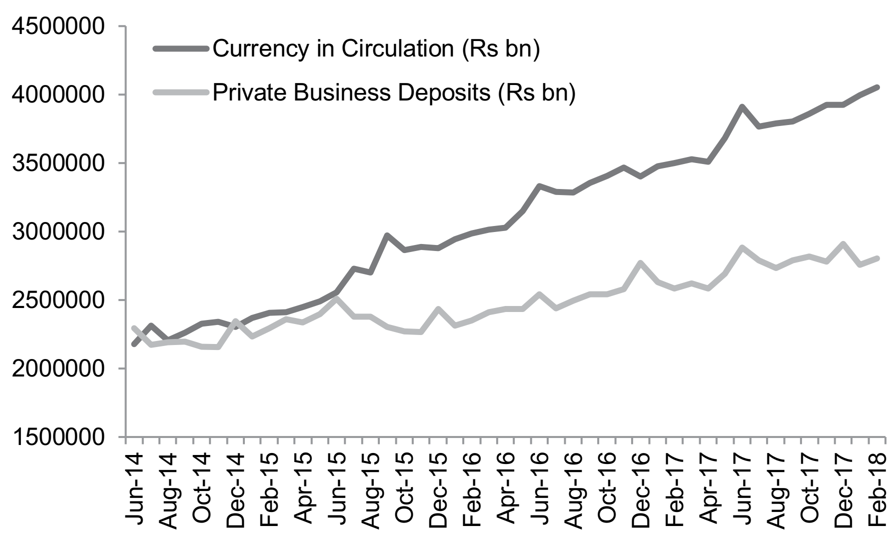
Fig 2.4

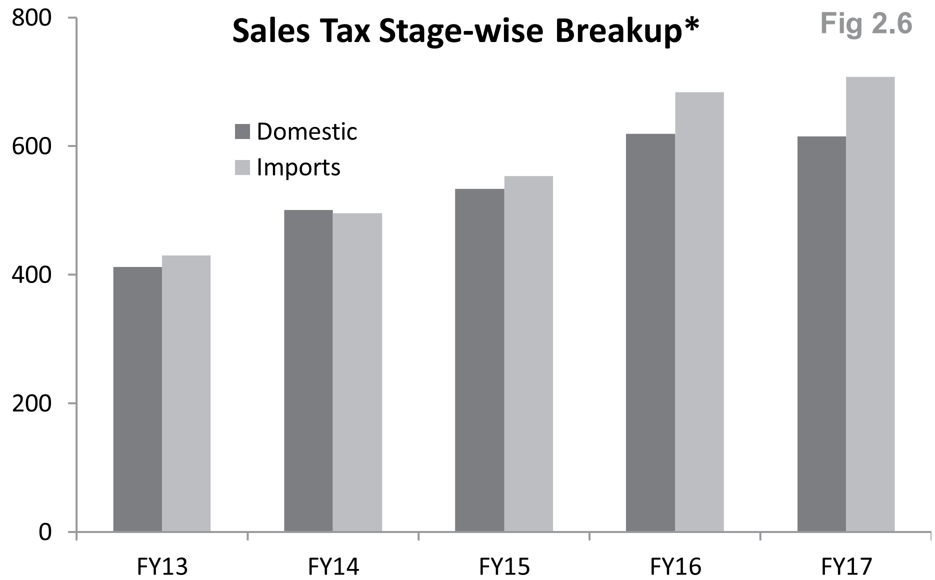


Source: FBR

Misfire - Impact of WHT on Banking Transactions

Fig 2.5





(Rs bn)
Source: SBP

6.4. Tax Rates and Equality

The government has followed a strategy to reduce corporate income tax by 1 percentage point every year, and has successfully brought it down to 30% for tax year 2018. But even the reduced corporate tax rate, compares unfavorably with the regional economies. (See Fig 2.7)

The sales tax incidence is also on the higher side, and the over reliance on indirect taxes, compels authorities to not tinker with the rate.

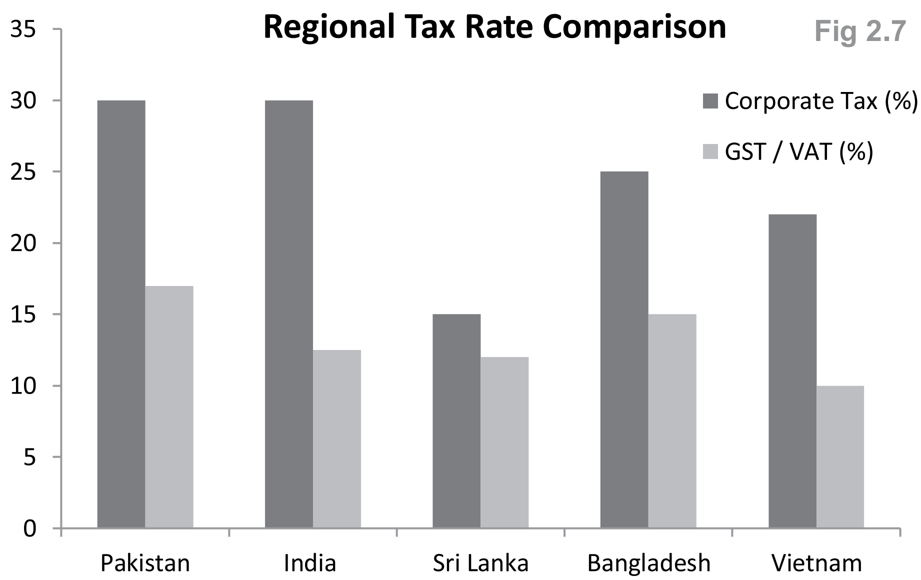
The tax incidence in all fairness ends up being much higher than just the 30% corporate tax rate. The tax on inter-corporate dividends at 15% often raises the tax rate for corporate sector to over 40%. In case of banking companies, the imposition of super tax at 3%, inflates the tax incidence. The tax on WWF and WPPF at 2% and 5% respectively, also adds to the equation, which could take the effective tax rate to as high as 55%.[11]

On the other hand, the effective tax rate on AOPs and individuals, in most circumstances does not exceed 22%, creating equality issues. This has given rise to the corporatization versus non-corporatization debate, as added compliance is fast becoming unfeasible.

[11] *Equitable Fiscal Policy, Pakistan Business Council*

Similar is the case of tax on trading, which puts manufacturers at a massive disadvantage. The share of manufacturing in exports, has gone down from 12.4% in FY12 to 8.9% in FY17, indicating at premature de-industrialization. The fact that manufacturers pay sales tax on the entire value addition chain, versus importers' sales tax on import value only – adds to the inequality.

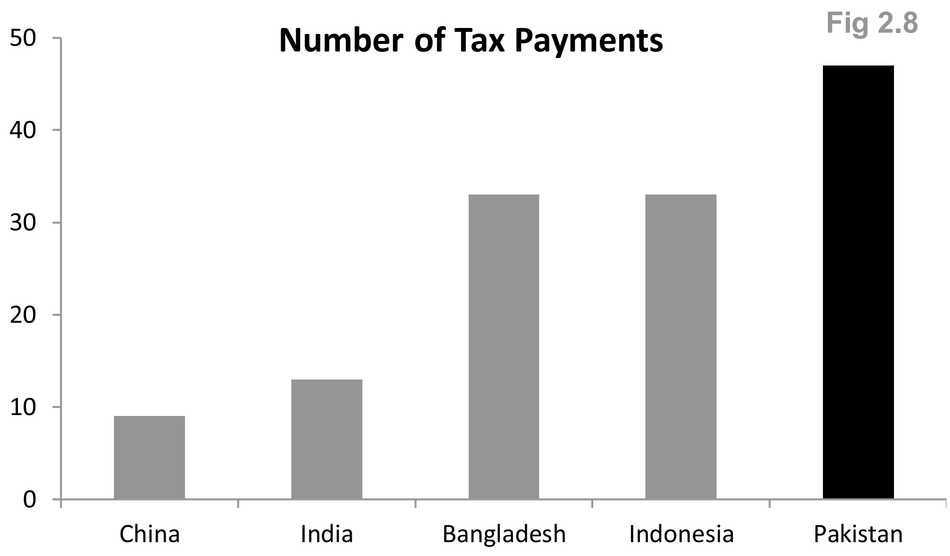
The issue of under invoicing is rampant and puts the organized sector at a massive disadvantage, because of the tax benefits that under invoicing brings. The presumptive tax regime continues to be a drain on the manufacturing sector, and is increasingly turning the country into a trading hub.



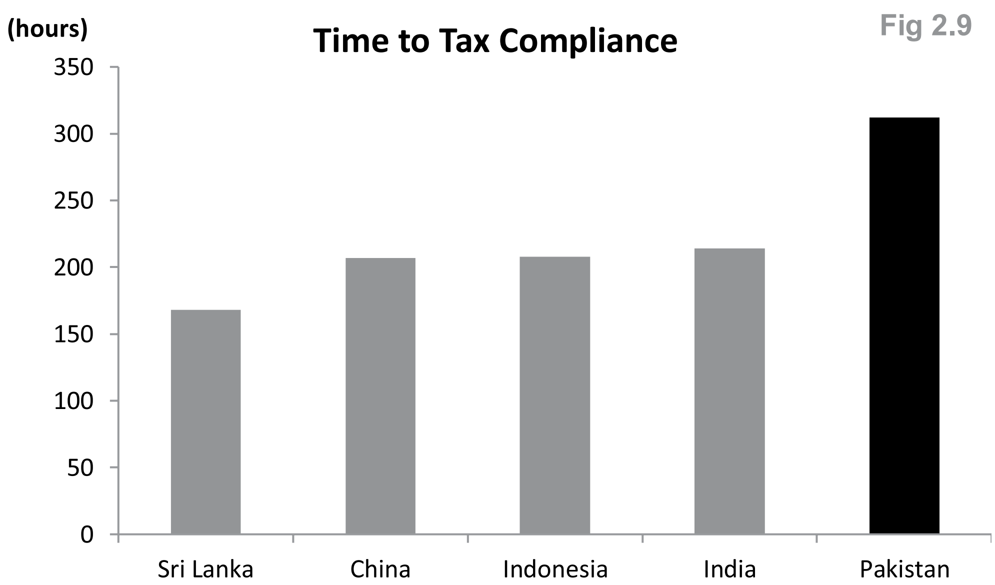
Source: World Bank

6.5. Tax Procedures

Policy issues and shortcomings aside, the sheer cumbersomeness of the tax filing procedure puts Pakistan on familiar low rankings on most tax payment accounts. The FBR has undergone technological transformation, aimed at streamlining the process, but the authority lags way behind in regional comparison. (See Fig 2.8 & 2.9)



Source: Paying Taxes 2018, World Bank Group



Source: Paying Taxes 2018, World Bank Group

7. Tax Reform Recommendations

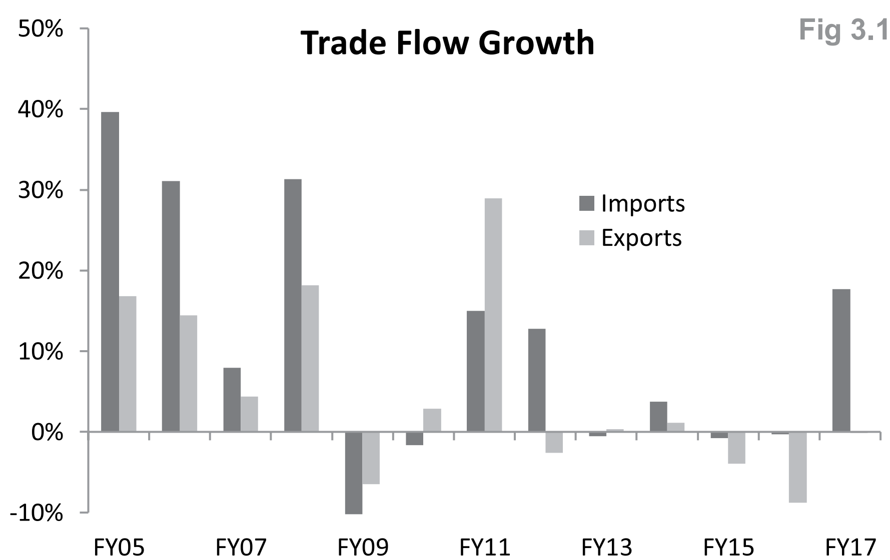
i. The government needs to deviate from target oriented tax policymaking, and make tax collection more equitable on the basis of social justice.
ii. FBR needs to reduce the number of payment and time it takes to comply.
iii. GST needs to be brought down to single digits, and simplified.
iv. The anomalies between manufacturing and trading sectors need to be removed, to support industrialization. Tax incidence on all businesses must be uniform and be brought down lower.
v. Presumptive tax regime has not yielded lasting results, and needs to be phased out gradually.
vi. Income based taxation model needs to be adopted, for improved tax-to-GDP ratio.
vii. Tax on dividends and Super Tax need to be eliminated to provide a level playing field and incentivize compliance.
viii. Reduce reliance on taxes on imports, and find ways to reduce under invoicing, to have more revenue space from other avenues.

Chapter 3: INTERNATIONAL TRADE

8. Trade Balance

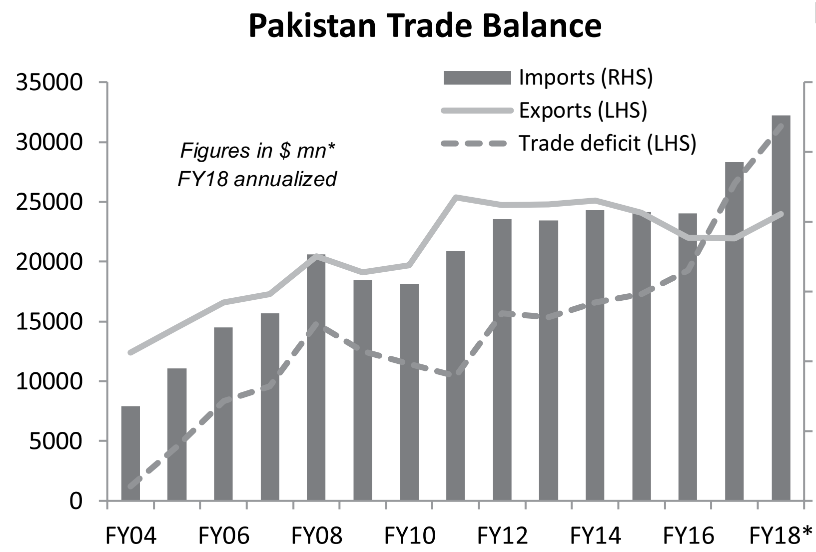
Pakistan's international trade has been a cause of worry for quite some time now. A lot of Pakistan's economic woes could be traced back to the deteriorating balance of trade. For an expanding economy, with increasing purchasing power, more urbanization, and high consumption patterns – imports were always going to be paced higher. As a percentage of GDP, exports have come down to single digits – lowest over the decade.

By FY17, Pakistan's imports grew by 21% from FY13, whereas, exports in the same period went down by 12%. (See Fig 3.1) This resulted in widening of the trade deficit to nearly 10% of GDP, having almost doubled in five years. The mismatch between exports and imports has grown to the level that the trade deficit has exceeded annual exports. (See Fig 3.2)



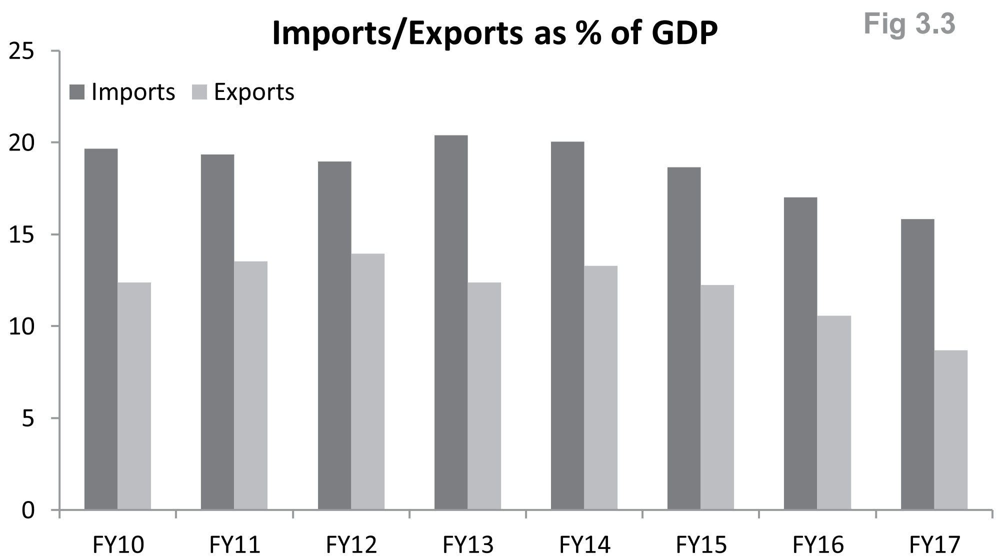
Source: SBP

Fig 3.2



Source: SBP

Fig 3.3



Source: World Bank

8.1. Import Trends

Pakistan's imports have undergone a major shift in last five years. The imports grew by 21%[12] by FY17 over the course of five years, which is not a massive jump for an

[12] *Pakistan Bureau of Statistics*

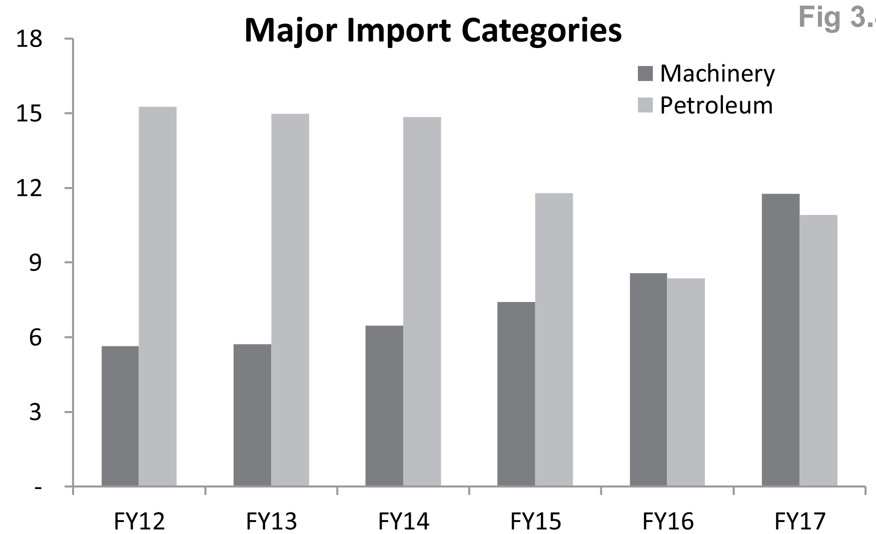
economy in growth mode. Two top import categories of late have been machinery and petroleum groups, both of which have had contrasting journey in the last five years.

Machinery group has leapfrogged two places, overtaking food and petroleum groups, and is the top import category. Machinery imports have by far outpaced imports in all other categories, having grown by a whopping 106% over five years, as against 21% overall imports growth. The share of machinery imports in total imports has also grown steadily from 13% in FY13 to 22% in FY17.

Much of that shift has come in FY16 and FY17, as CPEC related projects gathered full steam. Within the group, power generation constituted the lion's share, as two-thirds of the CPEC power projects were placed under the early harvest program.

The machinery imports have started to show a slower rate of growth, which is evident from the decline reported in the PBS numbers. Power generation machinery has reported a YoY decline in imports during 1QFY18.[13] That said, the SBP numbers will continue to show the impact of high machinery imports, as import payments in 1QFY18 grew by 80% YoY, versus a slowdown in custom imports reported by the PBS. The impact is also visible on interbank payment, with the currency facing pressure.

Fig 3.4



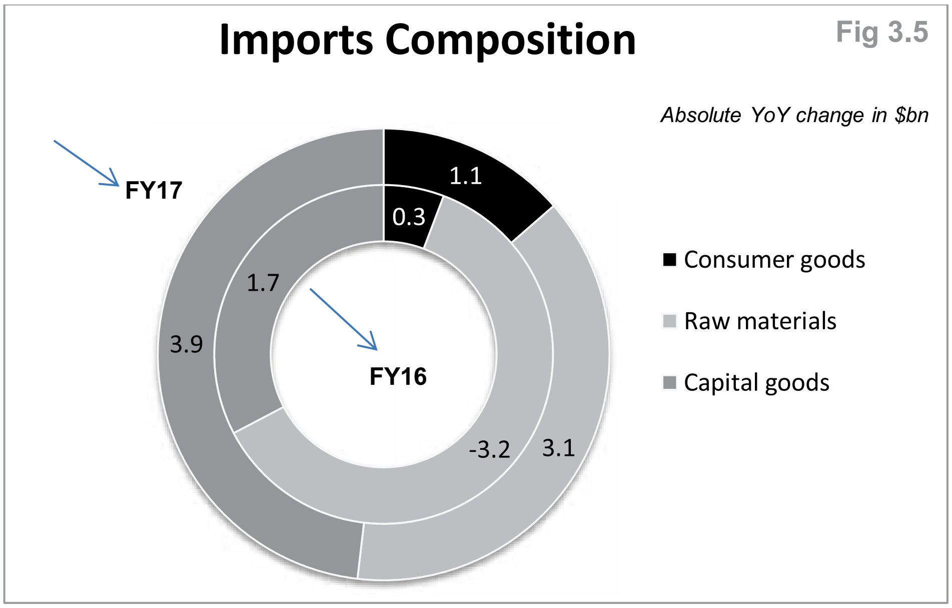
Source: PBS in $ bn

On the other hand, imports of petroleum group subsided 27% by FY17 over FY13. The single largest factor to lower petroleum imports was a massive decline in oil prices during the period that offered a breather. In terms of volume, petroleum imports largely remained flattish – dropping only in 1HFY18, as more LNG started coming to the

[13]*State of the Economy 1QFY18 - SBP*

system in place of furnace oil. Share of petroleum imports in total imports has gone down from one-third in FY13 to 21% in FY17.

The transformation in import break-up also means that the share of capital goods has been growing at a faster pace. Much of this owes to CPEC projects, in the construction and power sectors. (See Fig 3.5) Moreover, improved macro and security situation has also yielded results in form of many manufacturing concerns going for expansion. There has also lately been a surge in investments in the automobile sector – all of which have combined for a greater share of capital goods in imports.



Source: PBS

To fuel the capital goods, raw material import has also picked pace over the previous years. Granted that the increase in commodity prices also has a role in higher raw material imports – but the base of raw material utilization has surely expanded, as evident from expansion in power, construction, cement and auto sectors. The trend also suggests that most raw material import is being utilized for incremental value addition in the economy, which could yield better results going forward.

The share of petroleum group in imports is all set to reclaim the top spot from machinery, as nearly 40% increase in power generation capacity in last three years, would require more fuel to burn. The petroleum imports would take another 3-4 years before going down, once mega projects based on indigenous fuel come online.

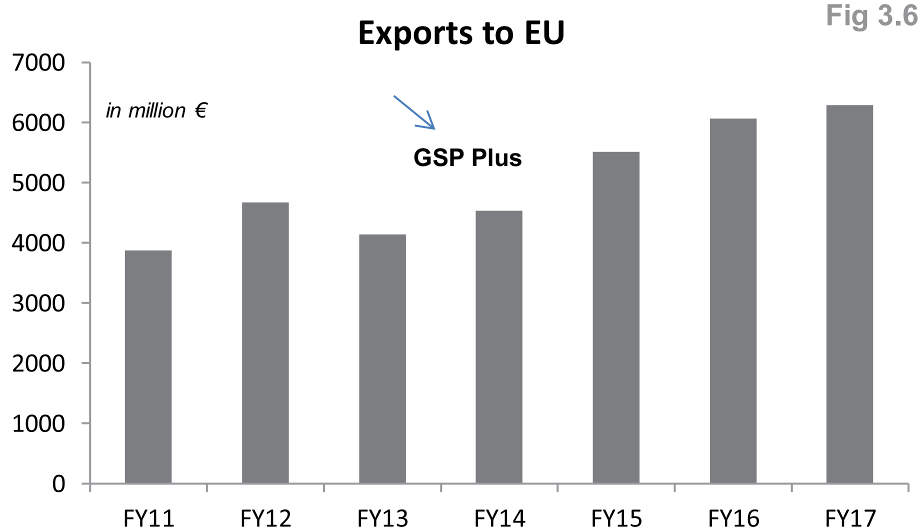
8.2. Export Trends

Pakistan's exports have been under pressure for so long that a respite of 12% YoY increase in 8MFY18 seems a recovery. Pakistan's share in global exports has been consistently falling and was down to 0.12% in FY17, from the high of 1.93% back in FY05. Having witnessed three back-to-back years of declining exports, FY18 promises to be a better performing year in terms of export earnings.

Slowdown[14] in global economy, particularly major Pakistan export destinations in the EU and the USA put immense pressure on exports. The slowdown in industrial production at home, as LSM growth dipped to 2.9% in FY16, also contributed to low exports.

From FY13-FY15, the energy situation (*See Chapter 1*) was far from ideal, causing long interruptions in industrial manufacturing. For Pakistan, the GSP Plus came at a good time, coinciding with improved energy availability (zero load shedding for industries). The currency depreciation in FY18 promises to further strengthen Pakistan's export case.

Fig 3.6



Source: European Commission

The much improved economic conditions in Pakistan's major export destinations hold a good future. The government's export support package to the tune of Rs180 billion is also expected to offer able support for the textile sector to stay afloat. But if Pakistan is to make more inroads, it will have to try and catch the missed train, as competitors have

[14] *State of the Economy FY17 - SBP*

outpaced and outplayed Pakistan in terms of sophistication, diversification, penetration and competitiveness.

Textile sector cannot forever continue to be behind the curve, now that it receives much improved energy. Yet, the growth in textile production, according to latest PBS numbers is next to nothing.[15] One reason often cited by textile sector is increased cost of production, particularly, that of energy. Also, the export package has not resulted in enough payments for a few segments.[16] Should this situation continue, Pakistan would forever struggle to just stay afloat, let alone, ever catching the missed train.

9. Regional Trade

Pakistan's geographical proximity demands it to be more open to trade across borders. Only that, political measures have superseded rationale calls more often in Pakistan – which is why Pakistan is ranked a lowly 171 out of 189 countries. [17]

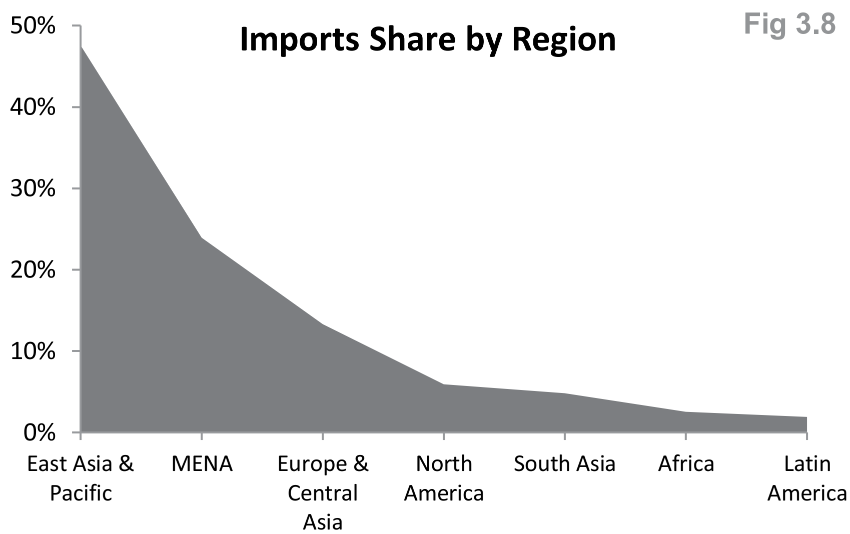
Fig 3.7 **Trading Across Borders - Regional comparison**

	Trading Across Borders rank	Time to export (hours)	Cost to import (USD)	Time to export (hours)	Cost to import (USD)
Pakistan	**171**	**75**	**406**	**129.3**	**936.6**
India	146	106.1	382.4	264.5	543.2
China	97	25.9	484.1	92.3	745
Turkey	71	16	376	41	655
South Asia	126	59.4	369.8	113.8	638

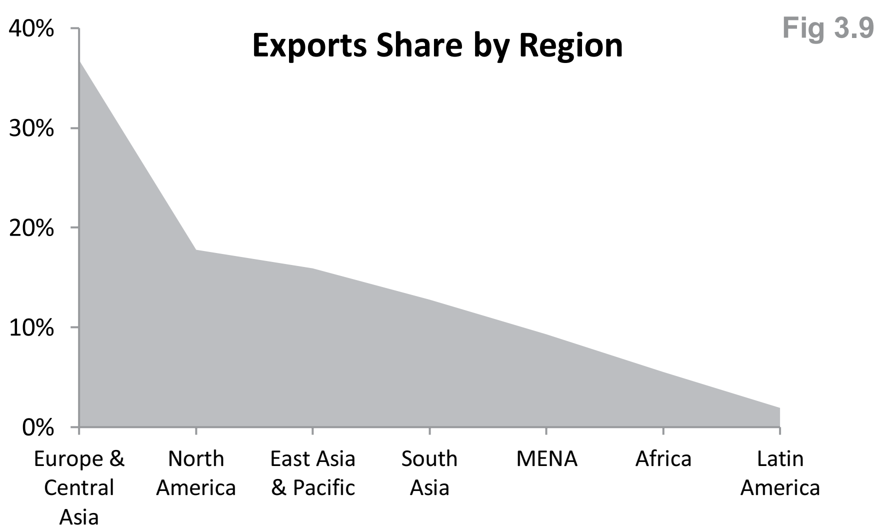
Source: Doing Business, World Bank

Pakistan's trade with South Asian partners is almost negligible at 8%, whereas ASEAN countries have 56% of the total trade within (See Fig 3.8 & 3.9). The neighboring India trades two times as much with Sri Lanka, and three times as much with Bangladesh, than it trades with Pakistan[18]. Pakistan ends up paying more for its imports, and earning less for exports, as a result of such negligible trade with a country as big as India.

[15] *https://www.brecorder.com/2018/03/08/403564/will-textile-output-post-zero-growth-in-fy18/*
[16] *https://fp.brecorder.com/2018/02/20180226347327/*
[17] *http://www.doingbusiness.org/data/exploretopics/trading-across-borders*
[18] *Presentation by Dr. Manzoor Ahmed on Open Trade*



Source: World Bank



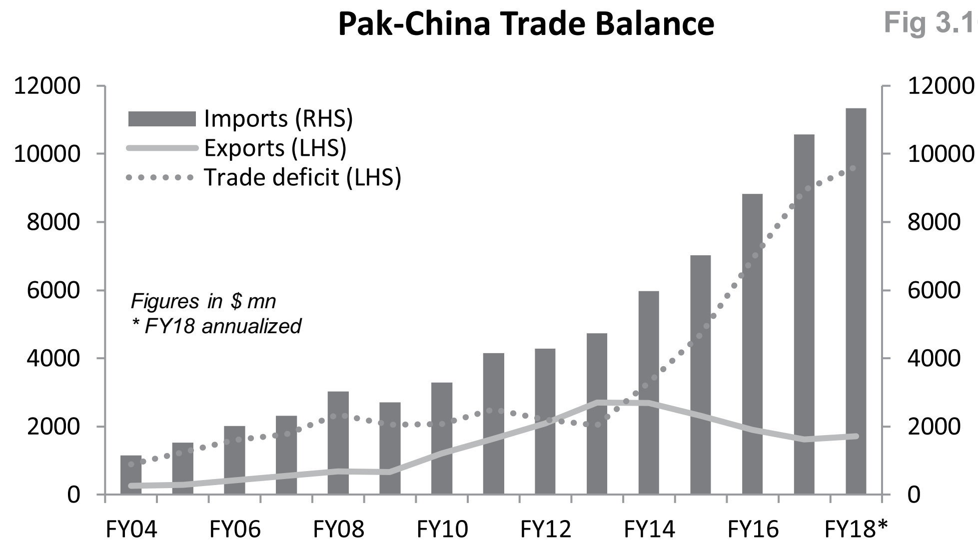
Source: World Bank

Moreover, poorly negotiated FTAs over the years have contributed to high trade deficit. Pakistan is currently part of 8 tariff agreements with different partnering countries,[19] with most of whom, Pakistan has run a higher deficit, since entering trade agreements.

[19]*https://wits.worldbank.org/CountryProfile/en/Country/PAK/Year/2016/Summary*

Pakistan's trade deficit with China has almost quadrupled in last 4 years, and has grown by 8 times since the FTA in 2005. (See Fig 3.10) Other FTAs barring one with Malaysia have also yielded higher trade deficit for Pakistan. The negotiations for revised FTA with China are underway, and Pakistan would do well to not repeat the mistakes, and try and gain concessions on the ASEAN model.

Fig 3.10



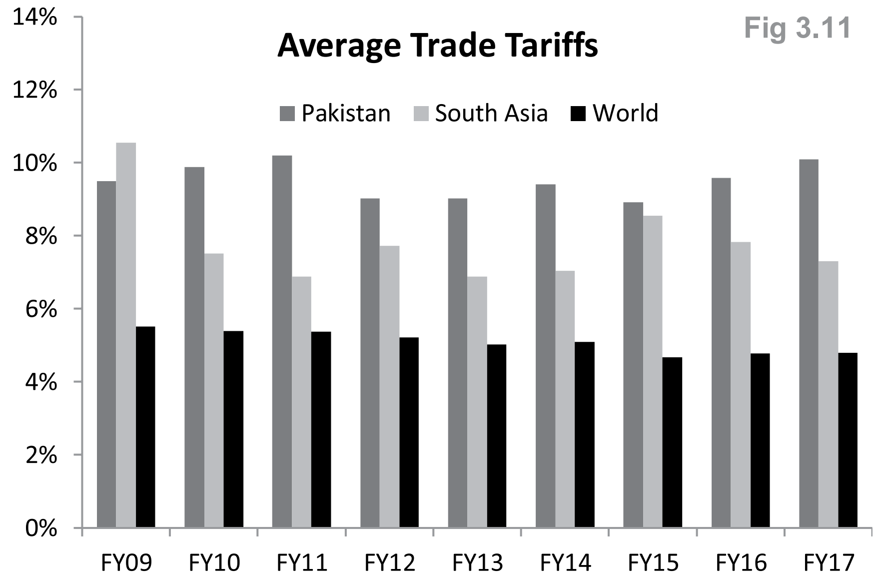
Source: SBP

FTAs with Turkey and Thailand are also under consideration, and Pakistan runs huge trade deficit with both these countries already. It would be difficult for Pakistan to get unilateral concessions from either, but if negotiated well, better results could be yielded.

10. Trade Tariffs

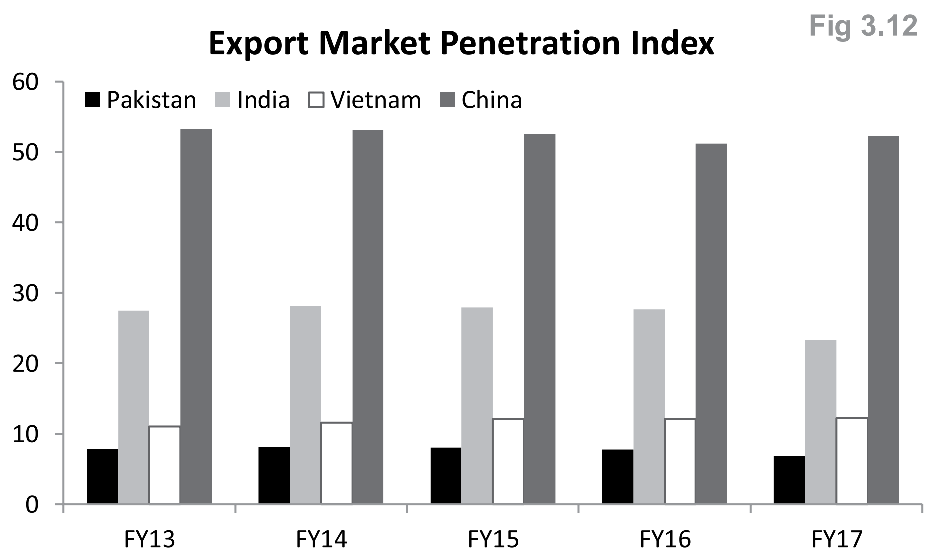
Tariff barriers have long been a bane to Pakistan's trade profile. While, most other countries in the region have worked hard to reduce the overall tariffs, Pakistan's progress has been lackluster. Pakistan's weighted average tariffs stood at 10.09% in 2016 – and have virtually stayed in that range for nearly a decade. [20][21]

[20] *https://wits.worldbank.org/CountrySnapshot/en/PAK*
[21] *http://iresearch.worldbank.org/servicetrade/*



Source: World Bank, WITS

Pakistan ranks the lowest in the region on Overall Trade Restrictiveness Index and Services Policy Restrictiveness Database, indicating high trade barriers in terms of openness, tariffs, and competition. [22]



Source: WITS

[22] *http://iresearch.worldbank.org/servicetrade/*

11. Trade Reform Recommendations

i. Renegotiate FTA with China on ASEAN terms and earn better tariff concessions.
ii. Need to transform to diversified trade portfolio.
iii. Short-term concessional packages should be replaced with focused long-term policies.
iv. Enhanced focus on regional trade, and work on eliminating border and tariff trade barriers.
v. Move away from import substitution and focus on export based growth and be a part of the global value chain trade.

Chapter 4: PUBLIC DEBT

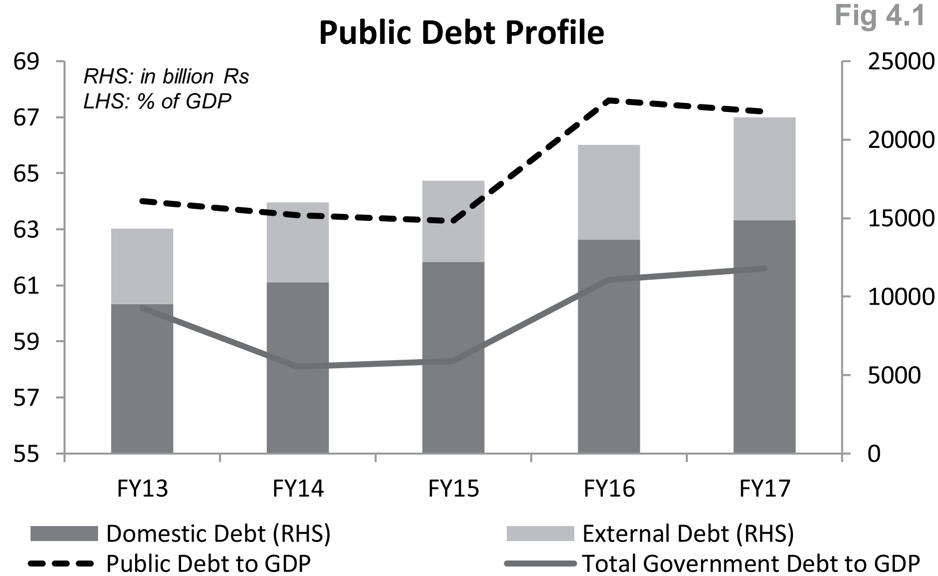
*** The PML-N 2013 agenda had not mentioned specific targets for public debt, having generally touched upon the need to be fiscally more responsible. This chapter contains less of tracking, and more of the pressing issues and the state of affairs with the overall debt situation.*

12. Public Debt

Gross public debt[23] in FY17 rose to Rs. 21,407 billion, or 67.2% of GDP, with 8% YoY growth. The rate of growth in public debt slowed down in FY17, from the earlier 3-year average of 12%. The increase in public debt almost perfectly mirrored the composition of budget deficit financing, as the share was split in 71:29 of domestic and external debt.

Market dynamics came into play to alter the composition of public debt in FY17, as low interest rates expectations resulted in low demand for long and medium term government papers. The share of short term securities in the public debt went slightly up from 40% in FY16 to 42% in FY17.

Fig 4.1



Source: Ministry of Finance

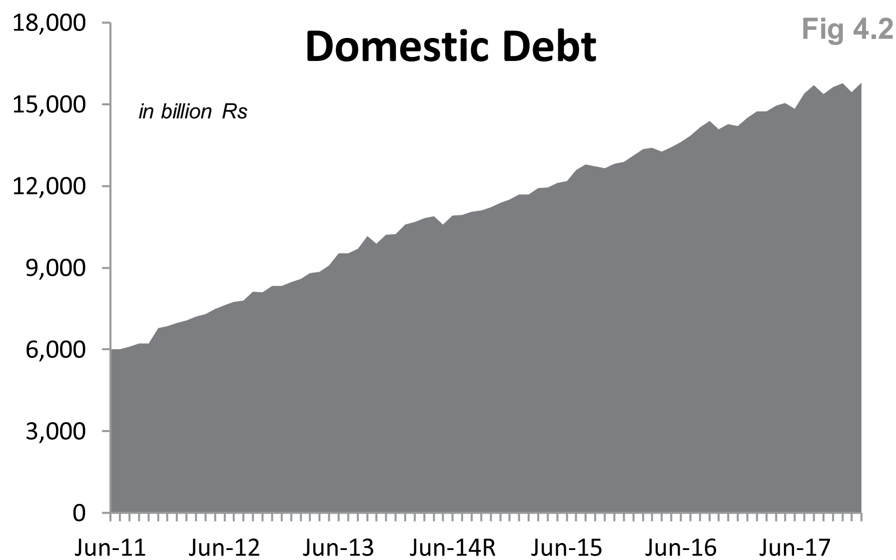
[23] *Total public debt is defined as debt of government serviced out of consolidated fund and debts owed to the IMF*

The alternation in public debt composition has not come with higher costs, as the government kept the risk and reward scenarios well in play. The adherence to Medium Term Debt Strategy (MTDS) ensured the cost of debt came down by 100 bps in four years.[24]

Some improvement was also witnessed on account of indicators of debt repayment capacity in FY17. The public debt to revenue ratio reduced by around 300 bps to 434, but there is still a long way to go to bring the ratio down to more sustainable levels of 350.

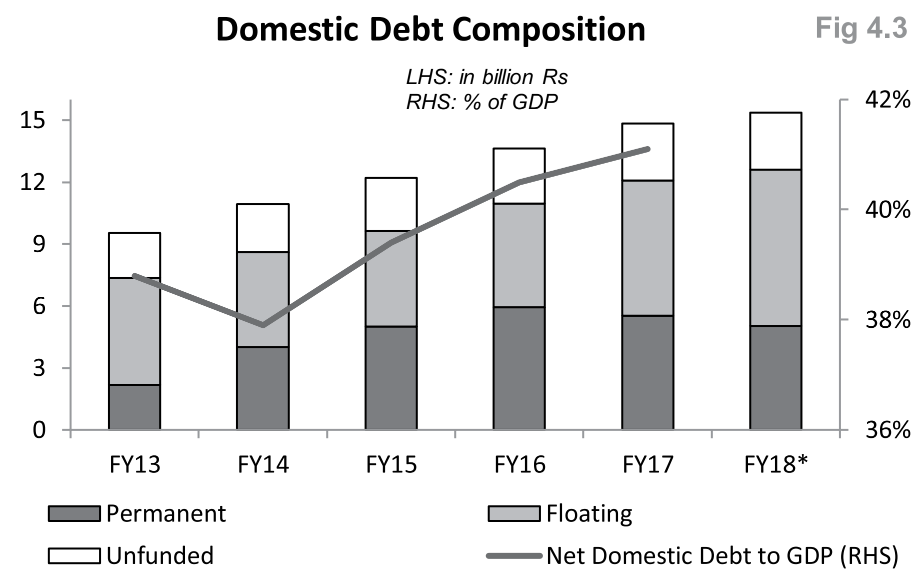
12.1. Domestic Debt

Domestic debt has continued to increase at double digit rates for the last four years. The interest rates dynamics throughout FY17 resulted in a much different domestic debt composition. The share of short term papers soared from 37% in FY16 to 44% in FY17 – as floating debt picked pace. Lower rates also meant that the overall domestic debt cost also came down by around 90 bps.[25]



Source: SBP

[24]*Debt Policy Statement 2017-18, Ministry of Finance*
[25]*Risk Report on Debt Management June 2017, Ministry of Finance*

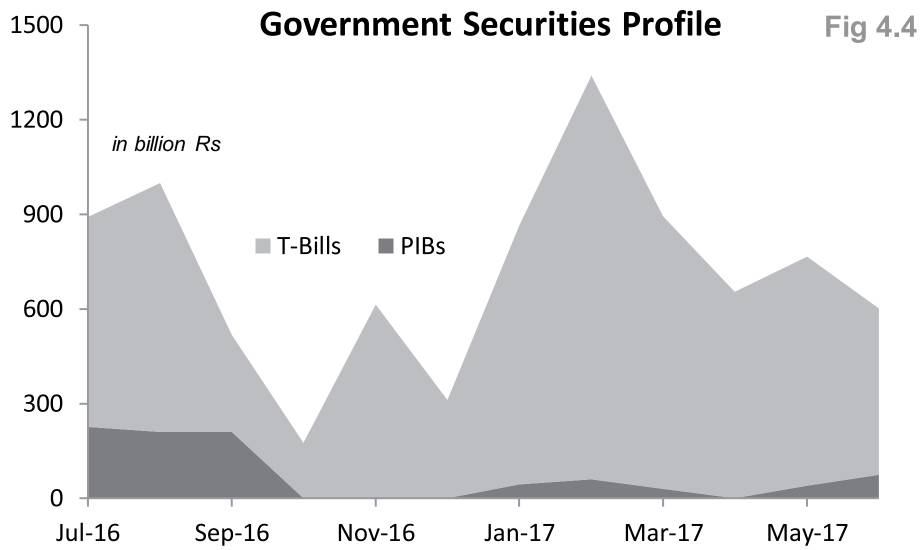


Source: Ministry of Finance Jul-Sep*

Effective implementation of the MTDS resulted in an overall reduction of nearly 250 bps in cost of domestic debt over four years. The biggest change in domestic debt profile was witnessed with Permanent Debt, as the share of permanent debt went down from 44% in FY16 to 37% in FY17.

Floating debt, on the other hand, gathered more steam, increasing by 30% YoY, as long term debt was retired by the government during FY17. The treasury market has taken a particular liking for short-tenor papers, and even within treasury bills, the visible preference was reserved for 3 and 6month papers.

The share of unfunded debt also dipped, as the low rates on offer predictably led to lower mobilization, despite revision in rates.



Source: SBP

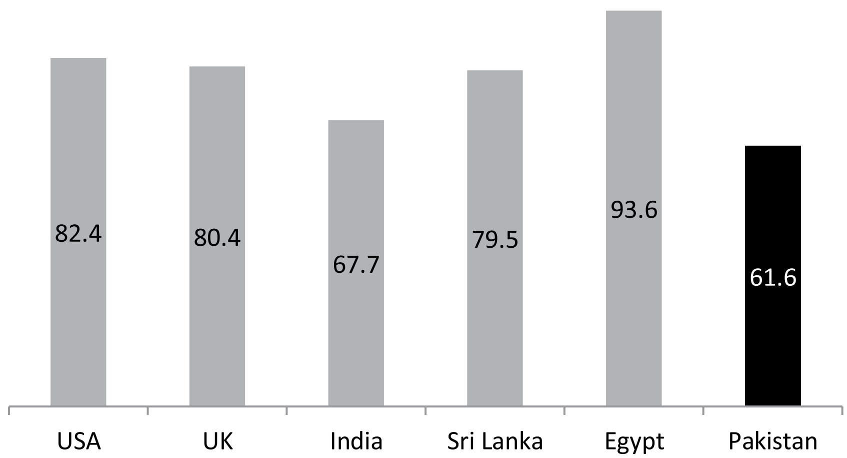
12.2. External Debt

Pakistan has maintained visible discipline on the external debt[26] front, as the toll increased by 8% YoY in FY17 – much lower than previous year's average growth, and in line with preceding 3-year average. Multilateral and bilateral debt has historically had the lion's share in Pakistan's external debt – and FY17 was no different with over 85% contribution from development partners.

Higher share of multilaterals and bilateral is also often an indication of the partners' confidence in the state of affairs. Such debt is aimed at improving productivity and is often cited as development loans – which other than budgetary support, aid the country's capacity to repay.

[26]*External debt include all foreign currency debt contracted by private and public sector*

Debt-to-GDP Comparison Fig 4.5



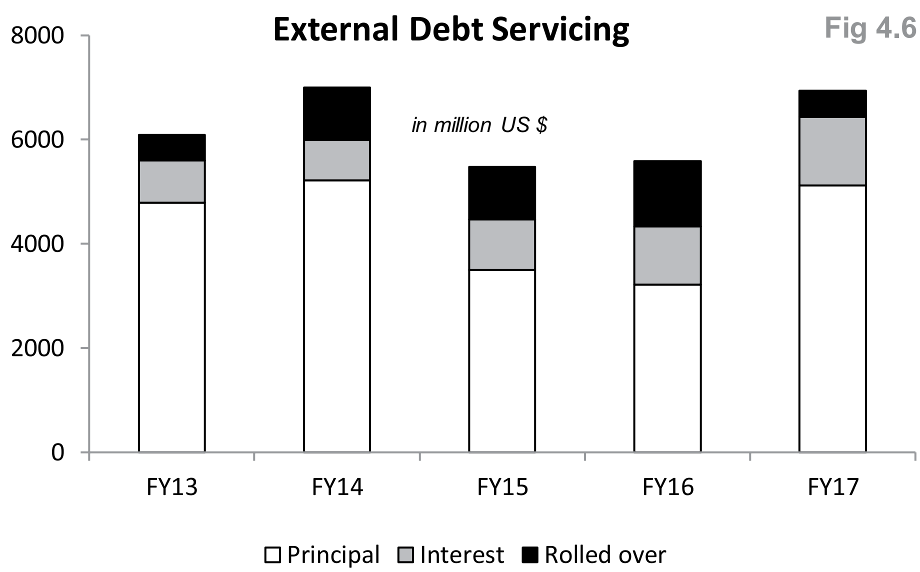
Source: IMF

Bulk of this disbursement was aimed at financing of public projects in energy, infrastructure, education, social spending and public sector management. Faced with pressing need, Pakistan also successfully issued Sukuk worth $1 billion – and fetched good rates in the international market.

Composition of external disbursements is a tell-tale sign of Pakistan's ever-increasing reliance on China, and also an indication of what CPEC holds in terms of debt profiling. Share of Chinese government or banks, in the total disbursements to Pakistan in FY17 was 38% - up from 21% in FY16.

The financing from Chinese banks is indicative of the ongoing CPEC projects, in power and infrastructure sector. Also, China's support in form of bilateral disbursement to the tune of $1.55 billion may also be a sign of things to come. Given Pakistan's worsening twin deficits, and falling reserves – it appears this bilateral entry may be a recurrence in external disbursements going ahead.

External Public Debt Servicing in FY17 clocked in 48% higher YoY, as higher repayments arose against commercial and multilateral loans. More than 40% of debt servicing owed to multilateral loans.



Source: Ministry of Finance

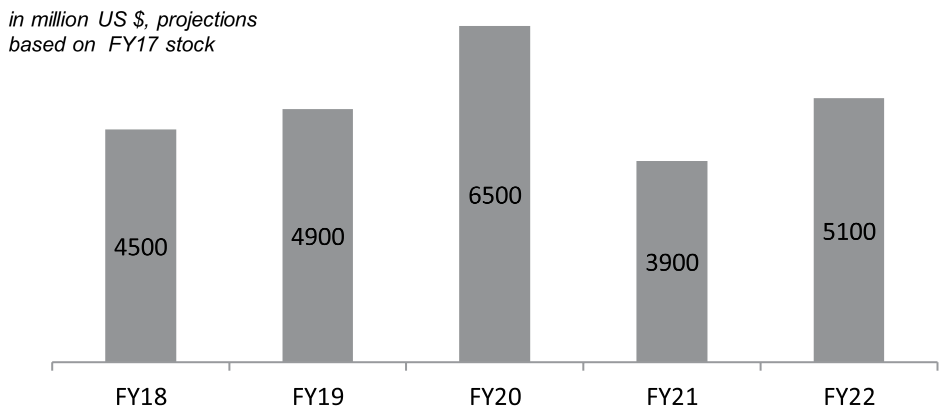
12.3. External Debt Repayments

Much debate has been going around whether Pakistan's exposure to external debt is sustainable – especially in the wake of massive fiscal slippages and sizeable fall in reserves. The Ministry of Finance does not seem too worried with any of the red flags raised by the IMF, related to Pakistan's ability to repay in the wake of growing external financing needs.[27]

The Pakistani authorities have expressed the notion that the country is under no dire threat of failing to meet any of its debt payment obligations going forward. As per the MoF working, Pakistan's external public debt payment obligations can be met without compromising on growth, rescheduling, or accumulation of arrears.

[27] *Debt Policy Coordination Office publications , Ministry of Finance*

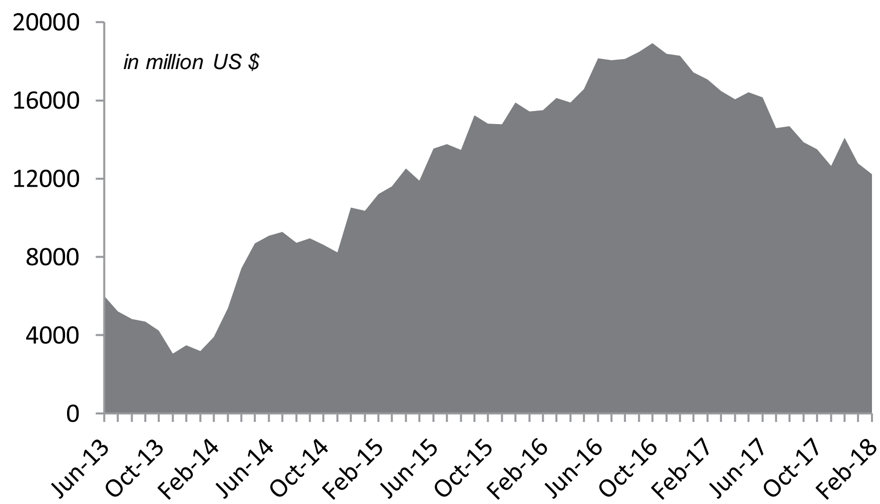
External Debt Repayment - Government Projection Fig 4.7



Source: Ministry of Finance

Going by government’s projections, repaying an average $5 billion annually for next five years, must not be a problem. Pakistan has had to pay higher amounts, in times of much lower reserves.

Forex Reserves with SBP Fig 4.8



Source: SBP

But the IMF thinks otherwise[28]. According to the Fund, Pakistan is on track to breach the FRDLA[29], on both accounts of fiscal deficit and public debt, in the medium term. Pakistan's debt level of public debt at 67% of GDP in FY17 stayed much higher than earlier committed with the IMF.

Fiscal deficit has widened since, due to revenue slippages and expenditure overruns. The IMF expects public debt to stay around 66-67% of GDP by 2023, which is close to the current levels. The shock absorbing premium has gone up, as any adversity to GDP growth or fiscal balance, could trigger public debt north of 70% of GDP.

The IMF does not see an immediate threat to Pakistan's ability to repay its external debt, as it is well within sustainable limits. But the Fund has raised the red flag, that falling reserves and growing external financing needs do pose grave external risks.

The IMF has projected external financing needs and debt servicing to double by FY22 to $41 billion and $20 billion, respectively. Some of the IMF concerns on external payments seem overblown, as Pakistan can still manage to source external financing, without having to go to the IMF. But to some, it is an inevitability – and not a matter of if, but when.[30]

Some threats are real, as the fall in reserves has been alarming, and has brought down the import cover to less than 3 months. Should oil price inch up and stay on the higher side, all the available cushion would be wiped away.

There has to be a better sense of problem realization in the Q Block. Pakistan faces a dire deficit situation and that is what could put more pressure on debt sustainability. Pakistan may well hold its own and see the difficult phase through, but it should do so with a more determined sense of commitment and responsibility.

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[28] *IMF – Country Report on Pakistan – March 2018*

[29] *The FRDL Act imposes a limit on the federal government budget deficit (excluding foreign grants) of 4 percent of GDP for FY 18–FY20, and 3.5 percent of GDP thereafter, and a limit of 60 percent of GDP on the general government debt until FY18.*

[30] *https://www.brecorder.com/2018/01/17/393560/knocking-the-imf-again/*

Chapter 5: STATE OWNED ENTERPRISES

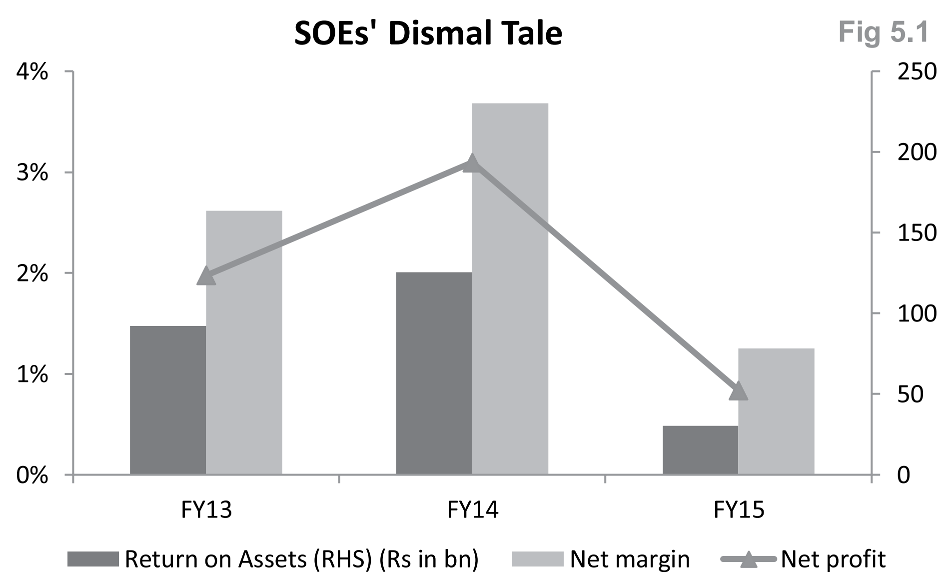
13. SOEs' Performance Overview

Of the entire sector 'reforms', it was the State Owned Enterprises (SOEs) that expectedly received the lowest rating points, in the 10th Tracking Report of PRIME Government Policy Scorecard. The only surprise was that SOEs were considered worthy of receiving 1.25 points out of a possible 10. By all means, this was grace marking, as SOE reforms have miserably failed to occur. If anything, the situation has worsened from when the government took over.

A look at the financial performance of leading profit and loss making SOEs suggests, the bad SOEs have become worse and the good ones have been confined to one sector.

The 183 SOEs, employing over 400,000 employees, as per the 'latest' official report[31], amassed a grand sum of Rs52.3 billion in net profits. This translates into a net profit margin of 1.25%, and Return on Assets (ROA) of 0.48%. If dire straits were a picture, Fig 5.1, would be it.

Fig 5.1



Source: SOEs Performance Review 2014-15

It is interesting to note that 8 of the top 10 profit making and 7 of the top 10 loss making SOEs represent the energy sector chain. The hydrocarbon chain contributes most to profits and government dividends. The power distribution companies

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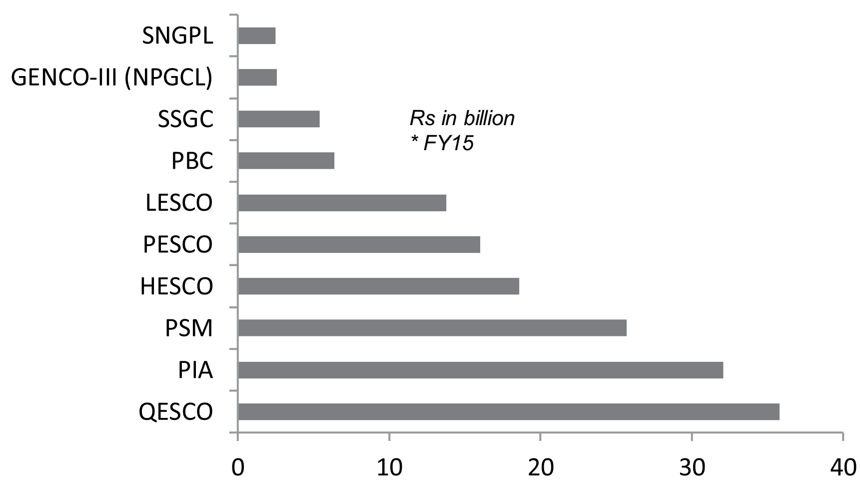
[31] *Digital Footprint: SOEs Performance Review 2014-15*

contribute most towards SOE losses. Little wonder that the originators and sufferers of the circular debt chain mirror the SOEs' performance.

The heavy presence of power DISCOs in both profit and loss making lists is a stark reminder why DISCO reforms are imperative. Also, the massive fluctuation in profits YoY tells the dependence on international oil price is too heavy – and one bad year in terms of oil price – could push even the better performing SOEs to a corner, as happened in FY15.

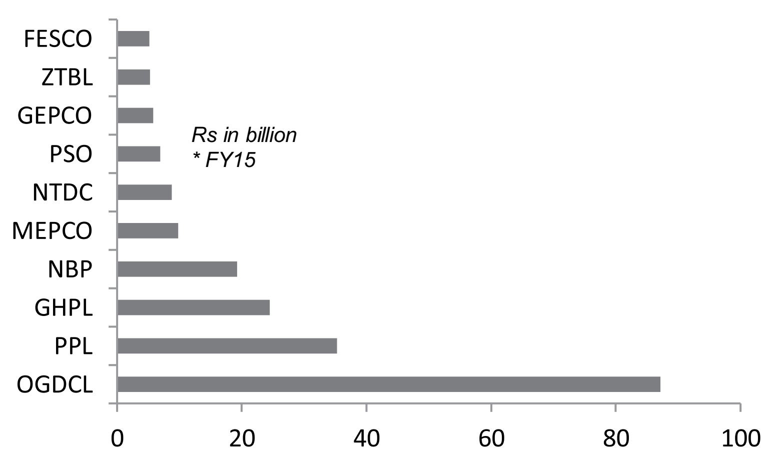
Top-10 Loss Making Commerical PSEs* Fig 5.2



Source: SOEs Performance Review 2014-15

Fig 5.3

Top-10 Profit Making Commerical PSEs*



Source: SOEs Performance Review 2014-15

PIA, PSM, and Pakistan Railways continue to be the usual suspects, ensuring presence in the top loss making list, year after year. No efforts of restructuring and revamping could stem the bleeding. PIA has continued the spree, with another Rs11 billion of loss already achieved in 1QFY17 – and seems well poised for another record breaking year.

Fig 5.4 **The White Elephants**

(Rs in bn)	Losses*	Accumulated losses
PIA	45	308
Pakistan Railways	33	37
Pakistan Steel Mills	26	119

Source: SOEs Performance Review 2014-15

** PIA losses are based on CY16 numbers*

14. Privatization &Restructuring

Privatization in Pakistan has been limited to capital market transactions of profit making companies. No concrete efforts have been made to restructure, corporatize and privatize SOEs, especially the ailing ones. Almost all SOEs earlier earmarked for privatization, got the cabinet's approval for the same. And inside the Privatization Commission's cabinets they remain, catching dust.

The single largest factor why SOE privatization has not taken off is political opposition. Both major opposition parties have time and again opposed the sale of SOEs, terming them strategic assets. Well, some of them may well be that, but there is hardly any strategy in injecting hundreds of billions of rupees year after year, to fund inefficient enterprises.

But the current government cannot shrug off the failure with this excuse. They have always known that privatization, for their political opponents, is against the very roots of their being. Also interesting is the fact that this government was under the IMF program for much of its tenure, but the IMF's push for privatization never went beyond a few stern mentions in evaluation reports.

The emphasis, in fact, remained on ad-hoc fiscal relief measures, such as imposing surcharges, levying new taxes, etc.[32] So while the IMF may well be all for privatization in principle, it always seems more concerned of immediate consequences. The 'structural' reform agenda seems confined to the papers.

[32] *IMF First Post Program Monitory Country Report – March 2018*

That the government has no business doing business is the very spirit that should form the basis of SOE reforms. In addition to political considerations, litigation possibilities, capacity and competence related issues, and improper marketing efforts have also played a role in keeping the privatization plan on hold.

In some cases, prior restructuring of SOEs is a prerequisite for privatization. But the efforts so far have been confined to ceremonial changes in the boards of a few organizations, with little intention to alter the management practices and institutional design. Political appointments and interventions thereon continue to mire whatever little progress there has been on some fronts.

The later it gets, the more difficult it will become to fetch good money from selling off SOEs. The losses are being accumulated at a brisk rate, and as time lapses, it gets increasingly difficult to bring about structural changes at any level.

The ground reality is that the current government on its last leg and outside the IMF program would not risk going for any such ‘adventure’. Scarier still, should there be a change of hands in the new government; privatization may not even be an agenda. This is not to suggest, that improvements cannot be made without privatization. But even restructuring without the intent of privatization, requires political will. And that has long been missing in the last two government tenures.

15. SOEs’ Fiscal Burden

The accumulated losses of SOEs had exceeded Rs1.2 trillion or 4% of GDP by December end 2017.[33] The circular debt stock had reportedly crossed Rs. 922 billion by March 2018, from Rs. 514 billion in December 2017. Summers are expected early in most parts, and without any chance of tariff rationalization or an overnight improvement in distribution and transmission system – it could alone exceed Rs. 1 trillion before the year end.

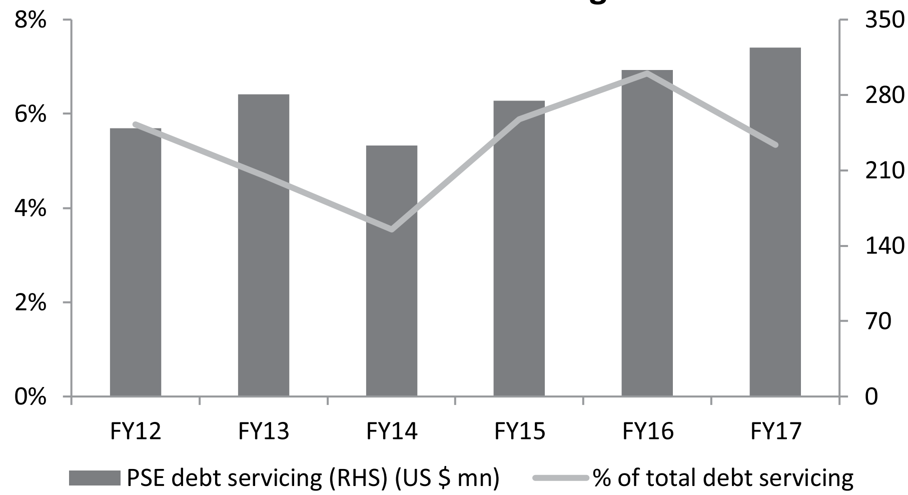
The situation would mean more burden on already limited fiscal space. Should the government decide to clear the circular debt partially,[34] it would add to the debt pile, without even remotely addressing the root causes.

[33] *IMF First Post Program Monitory Country Report – March 2018*

[34] *https://www.thenews.com.pk/print/289575-ecc-approves-plan-to-settle-rs80bln-power-sector-s-circular-debt*

Fig 5.5

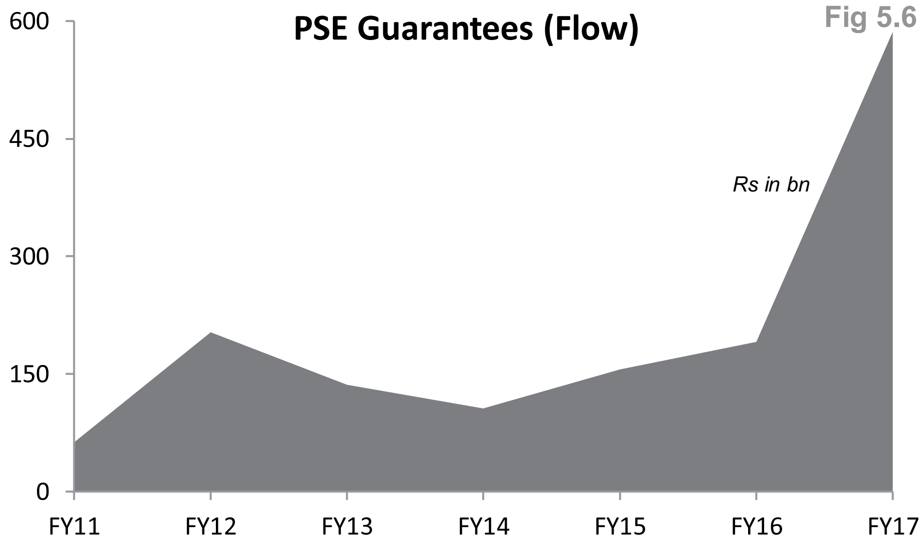
PSEs Debt Servicing



Source: SBP

PSE Guarantees (Flow)

Fig 5.6



Source: Ministry of Finance

The PSE debt stockpile has been on a rapid increase. The borrowing also reflects investment in energy and infrastructure projects. But without structural reforms, these grants and guarantees would eventually be a burden, as without improving efficiency, desired results would not be achieved.

Fresh guarantees for PSEs have seen a significant increase over the last one year, but remains within the FRDLA 2005 limit of 2%. Most of the PSE borrowing is backed by government guarantees, and the continuing losses could result in increased fiscal cost in the future.[35]

16. SOE Reform Recommendations

i. Privatize power sector DISCOs on priority basis, without the intention of earning proceeds.
ii. Sell-off the good DISCOs and utilize the efficient human resource and replicate management model in ailing DISCOs.
iii. Unbundle the entire power sector distribution chain, to increase competition and efficiency.
iv. Appoint subject expert management teams strictly on merit, and ensure no political interference in policy and procedural matters.
v. Ensure market competitive compensation to attract best talent from private sector.
vi. Put performance based incentive packages in place to encourage best practices and a sense of competition.

[35] *Managing contingent liabilities in Pakistan – Ministry of Finance*

List of Abbreviations

ADB	Asian Development Bank
AOP	Association of Persons
ASEAN	Association of Southeast Asian Nations
bps	Basis points
CIC	Currency in Circulation
CNG	Compressed Natural Gas
CPEC	China – Pakistan Economic Corridor
CY	Calendar Year
DISCO	Distribution Company (Pakistan)
EU	European Union
FBR	Federal Board of Revenue
FCA	Fuel Charges Adjustment
FO	Furnace Oil
FPA	Fuel Price Adjustment
FRDLA	Fiscal Responsibility and Debt Limitation Act
FTA	Free – Trade Agreement
FY	Fiscal Year
GDP	Gross Domestic Product
GENCO	Generation Company (Pakistan)
GSP	Generalized System of Preference
GST	General Sales Tax
HFY	Half Fiscal Year
IMF	International Monetary Fund
Kwh	Kilowatt hour
LNG	Liquefied Natural Gas
LPG	Liquid Petroleum Gas
LSM	Large Scale Manufacturing
MMCFD	Million Cubic Feet per Day
MoF	Ministry of Finance
MTDS	Medium Term Debt Strategy
MW	Million Watts
NEPRA	National Electric Power Regulatory Authority
OGRA	Oil and Gas Regulatory Authority
PBS	Pakistan Bureau of Statistics
PIA	Pakistan International Airlines
PML-N	Pakistan Muslim League (Nawaz)
PRIME	Policy Research Institute of Market Economy
PSE	Public Sector Enterprises
PSM	Pakistan Steel Mills
QFY	Quarter Financial Year
ROA	Return on Assets
SBP	State Bank of Pakistan

Annexure

ENERGY SECURITY				
	Agenda Target	**Status**	**Score**	**Comment**
1	Creation of a Ministry of Energy	The Ministry of Energy formed with power and petroleum as its two constituent divisions	10	Within the Ministry of Energy an implementation, execution and regulatory body with legislative powers, authority and necessary empowerment and (NEA), at the earliest to drive Pakistan's energy development in the right direction. Not the smartest execution so far. The recent LNG/Furnace oil fiasco is a big example that the current structure needs revamp. For improved execution, capacity building and an empowered functioning body is a must. A centralized and effective Planning Cell within the proposed Ministry of Energy should be created to improve integrated power sector planning for efficient and timely investments, production and evacuation of power.
	NEPRA Reforms			
2	Upfront tariffs for wind, solar, small projects	Middling achievement	5	NEPRA's scrapping of upfront tariff on most renewable has almost put an end to the upfront regime, moving into a much desirable competitive bidding regime. This may be a manifesto target missed, but a good one at that. It is going to have better results for the energy affordability aspect of the equation. It also creates a level playing field for investors. It opens up competition, and reduces government's risk.
3	Mandatory wheeling of electricity by DISCOs and the NTDC	Allowed but not mandatory yet	5	Mandatory wheeling was an unrealistic target. Permission of wheeling services is the right step aimed at building healthy competition. NEPRA has allowed wheeling services for dedicated buyers, which helps GENCOS find a more reliable and trusted customer, reducing the loss incidence. The arrangement between dedicated private supplier and buyers through DISCOs would result in inefficient players in the entire power chain to invest in improving infrastructure.
4	Net metering (sale guarantee) for small producers/consumers	147 solar installations approved for net metering	8.5	The phenomenon has not taken the market by storm yet, but NEPRA's rules of net metering are comprehensive and adhere to best practices. Distribution companies must be granted more legislative cover for net metering phenomenon to gather pace.
5	NEPRA determined tariffs to be the notified tariffs	NEPRA maintains that government must notify NEPRA proposed tariffs in 15 days' time unless challenged for review	10	NEPRA's powers to independently determine final tariffs have been considerably chopped. Government continues to allow and disallows NEPRA's determination, based on its own wish. NEPRA should be allowed to work as an independent and autonomous regulator, on the lines of the SBP. The NEPRA Act must be amended to enable and empower NEPRA to notify all determined tariffs. The current situation results in long delays in final tariff notification, and in some cases act as a deterrent for potential investors. Government's intervention has seemingly increased with the rapid increase in power generation. Clipping NEPRA's wings also results in irrational calls and added cost burden.
	DISCO Reforms			
6	Corporatization and privatization of DISCOS	No privatization of DISCOS was undertaken and they were already corporatized before current regime	0	Massive failure, as the government buckled under the political pressure. The failure looks worse, when seen in context of some improvements in recovery and losses indicators. Missed the chance to privatize easy low-hanging DISCOs. Inefficient management has been a drain on the overall governance of the sector as it also eats up valuable time and efforts of managers. Golden opportunity missed and may never be taken again.
7	Reduction of transmission and distribution losses to less than 10%	Transmission and distribution (T&D) losses for year ending June 2017 stood at 17.9%. T&D losses during Jul-Sep 2017 stood at	5	The better performing DISCOs have been found complacent, with each one missing the NEPRA allowed target. In more than half cases, T&D losses have actually increased, which shows the weakness in the system. The current T&D methodology errs on the lower side, as it excluded certain auxiliary and transmission losses. This is what exacerbates the circular debt problem, because it is based on inaccurate data. The original target was too ambitious to start with. Failure to achieve privatization goal

		19.6%.		ensured it would remain a distant dream. Massive restructuring and investment needs to be done to correct affairs, mostly at technical and governance levels. Privatization is the only way out.
8	Collection of electricity bills to 100%	Recovery at 94.1 in FY17 Recovery in 3MFY18 87.1%	**8**	Recovery rate in 5 out of 10 DISCOs improved from FY13. Half of the DISCOs faced deterioration in recovery ratio. Highly unsatisfactory performance. Collection could be improved with more advanced metering techniques. Enforcement of Theft Act is vital in enhancing recovery.
9	Ending of cross subsidy among DISCOs	Cross-subsidy still exists	**0**	The practice has not ended, but has been gradually brought down to nearly 2% of GDP to 0.7% of GDP. Better targeting and timely tariff determination is a must to eliminate cross subsidy. Ending cross subsidy would ease pressure on the circular debt stock, and would result in efficient management of financial affairs between DISCOs.
	GENCO Reforms			
10	Corporatization and Privatization of GENCOs under an independent Board.	No GENCO was corporatized or privatized under current regime though strategic sale of KAPCO was considered	**4**	All GENCOs were slated to be privatized, but never materialized. NEPRA has put GENCO's efficiency losses at over Rs200 billion per annum, resulting from underutilization, poor plant maintenance, and low availability factor. GENCOS dismal state and the inability to find a buyer or lack of willingness to sell have contributed greatly to the power sector woes. Old and inefficient units continue to be a drain on the entire chain and increase the overall system cost.
	Elimination of Circular Debt			
11	Eliminate circular debt	Circular debt touched Rs. 800 billion	**0**	Back to square one as the toll has crossed the 2013 level when the government took office. Inability to end cross subsidy, inefficient generation mix, poor coordination among various organizations, GST backlog, low collection, ever deteriorating transmission and distribution network - all continue to add to the woes. Need to notify tariffs in accordance with ground realities. The difference between actual and allowed T&D losses and recovery needs to be bridged to restrict circular debt. Timely payments from government on account of GST and subsidies need to be ensured.
12	Narrowly target subsidies for consumers up to 100 units	Subsidies are being maintained	**7.5**	Subsidies have been reduced substantially, but still continue beyond the 100 unit slab. Also, the slab system of incremental subsidy at times goes against the very principle of subsidizing the marginalized. Better monitoring needed, as misuse of subsidy is vastly reported by NEPRA.
13	Notify electricity tariffs according to the average system wide cost	Subsidies are being maintained.	**10**	NEPRA can only determine, but not notify the tariffs to the sector participants, a responsibility still retained by the Government. The notified tariffs are below the theoretical cost-recovery levels determined by NEPRA. The difference is meant to be covered by government subsidies, but is actually left unpaid as arrears.
14	Power dispatch to be strictly according to plan, efficiency and generation cost	Efficiency in distribution and management of load shedding observed.	**10**	The system operator was cautioned by NEPRA on non-observance of operation according to economic merit order. Certain efficient power plants were not fully utilized as per available capacities, whereas other plants were operated on the most expensive fuels. Economic merit order for power discharge and load allocations are not being strictly followed, although, there is visible improvement of late.
15	Ensure supply of gas to power plants	PM inaugurated country's second LNG terminal at Port Qasim	**5**	Much improved situation due to availability of LNG, and better gas supply management following the National Power Policy 2013. Improved power generation fuel mix is slated to result in reduced average system generation cost.
16	Rationalization of energy tariffs in line with international prices across all fuels	Fuel price adjustments are made from time to time in electricity bills to account for changes in fuel prices however the government has the final authority.	**5**	Pricing of fuels is largely rationalized and incorporated accordingly. Delays in notifying FPA often results in massive backlogs and arrears.

	Reforms of Oil and Gas Regulatory Authority			
17	Blanket ban on new CNG stations	Blanket ban on new CNG stations was imposed and continued.	**10**	Long overdue step, rightly taken. Growth of gas consumption in transport sector has come down from 10% in FY13 to 4.9% in FY17. The ban needs to continue, and be confined to use in public transport.
18	Priority to public transport in the use of CNG	CNG was provided on priority basis to public transport during crisis	**10**	CNG was provided on priority basis to the public transport during the crisis years. Anecdotal evidence suggests, no such mechanism s in place to prioritize usage of CNG.
19	Tariff rationalization in gas sector	KP government has rejected OGRA's proposal for variable tariff regime for SNGPL and SSGC. The objection is that provinces have no representation in OGRA.	**3**	Inter-agency arrears in the gas sector, although still low, have been rising, reflecting limitations in the current cross-subsidization arrangement between the two publicly-owned gas companies and delays in updating gas tariffs. Weighted average pricing still lacks, in addition to low prices for domestic sector which encourages misuse. It is about time the natural gas is priced in accordance to the overall system cost, accounting for ever increasing share of imported gas.
20	Narrowly targeted subsidy for natural gas and LPG users	Subsidy is available for households consuming up till 300 M3 per month.	**10**	Cross subsidization continues to date, and remains largely untargeted. The poorest segment still has higher cost for burning fuel than the connected domestic sector. Prices must go up to discourage misuse and improve revenue targets.
21	Aggressive wellhead pricing for oil and gas exploration companies	Government introduced market based pricing but oil & gas exploration remains less attractive due to prices.	**8**	E&P policy is attractive on most grounds, but the investment has largely been held back due to adverse law and order situation in key exploration potential areas.
22	High priority to import gas through pipelines	Priority is now being accorded to imports of Liquefied Natural Gas (LNG) by sea	**6**	The IP pipeline is almost dead, as the US continues to oppose. TAPI pipeline may happen in the longer run, but is not the most viable option. Imported LNG can still work, and the government has struck a safe long term contract that ensures timely supply.
23	Setting up of coal and LNG import terminals, and coal transportation facilities	Pakistan's first coal-import terminal has started commercial operations at Port Qasim. LNG import terminals also working.	**10**	Rapid progress on these fronts, mainly because of being part of CPEC. Gives the country assurance of uninterrupted supply of gas and coal. The pace of work on power plants based on locally produced coal has been painstakingly slow.
24	Development of Thar coalfields and setting up of at least 5,000 MW of new coal fired power plants under the PPP mode in Sindh	Second unit of 1320MW Sahiwal Coal-fired power plant inaugurated on 2nd July. CPEC entails development of several coal-fired power plants and coal mines	**7.5**	Fast progress on plants based on imported coal. Progress in Thar has been slow. Coal fired plants at long distance from ports are misplaced and will add to transportation costs
25	Developing alternative renewable energy sources	Sachal 50MW, Hydro China Dawood 50MW and UEP 100MW Wind Farms have achieved operational status	**8.5**	Good progress on most fronts. Cost have come down by over 25% in 4 years. Capacity addition must be done keeping in view base load requirement and mandatory capacity payment.

26	Decentralizing and creating a wholesale market for electricity	A wholesale market entails a multi-buyer, multi-seller market of electricity and the government continues to be the sole buyer	**5**	Unbundling of electricity market has to be hastened. NEPRA has done most of the homework in this regard. Capacity building and willingness to let go of monopoly required at the CCPA.

TAX REFORMS				
	Agenda Target	**Status**	**Score**	**Comment**
1	Bringing informal economy into tax net	Filers to get lower rate of 0.4% WHT on banking transactions till January 2018, as compared to 0.6% for non-filers50 But no overall institutional reforms were undertaken to achieve this target and even the lower WHT has an insignificant effect.	**2**	Continuation of and ever-increasing reliance on Presumptive Tax Regime shows government's inability to bring the undocumented sector into tax net. Nearly two-fifth of 'direct tax' is also 'indirect' as it is not based on 'net income'. The actual tax-to-GDP would be even lower than the envisaged target of 15%, if the informal economy is also taken into GDP computation.
2	Broadening tax base	Number of filers has declined to 1.07 million from 1.2 million.	**2.5**	New Active Taxpayers List by the FBR indicates that the number of tax filers by March 2018 had reduced from 1.32 million in Tax Year 2016 to 1.2 million for Tax Year 2017. Little to no effort has been made to broaden the base. The old tried, tested, and failed methods of regressive taxation are still being adopted.
3	Tax all income	Agricultural Income is still exempt from federal taxes (provincial taxes apply).	**0**	Agriculture income tax collected by provinces largely continue to be of presumptive nature. The collection is still based on land and not income, resulting in heavily disproportionate collection, relative to the GDP contribution.
4	No increase in tax rates	No further increase in tax rates post-budget FY2018	**8**	The imposition of super tax on banking companies has also nullified the impact of downward revision in corporate tax rate. The FBR increases sales tax on five export oriented sectors from 5% to 6% in the name of rationalizing tax incentives. Zero rating on commercial fabric import was also withdrawn and is now charged at 6%.
5	Reduce tax evasion	Modest progress seen in selective sectors	**2**	Some schemes to create social duty awareness and threatening to name and shame launched, but have not worked. The issue of under invoicing continues to date, and there are no incentives for those not filing returns. The cumbersome FBR procedures also make the task daunting. Around 40% of the companies registered with the SECP are non-filers. Tax evasion by commercial importers is rampant, and in some cases goes as high as 60%, hurting local manufacturing.
6	Reform of tax administration (both federal and provincial)	No reform	**0**	The fact that the FBR has not been able to rope in more active taxpayers is testament to the institutions' under par performance.
7	Ensuring tax compliance by small businesses	Incentives introduced, but compliance not ensured	**3**	The cost of compliance continues to outweigh incentives of filing tax returns. The over reliance on WHT also acts as incentive for most small businesses to take the route. The disparity in actual tax rate between corporate and small business/traders is huge and as per a PBC study, runs as high as 20%.
8	Publish annual tax directory	Directory updated and published online	**10**	Target achieved and serves good purpose for research and provides space for recommendations to improve.
9	Reduce number of federal and provincial taxes	No such reduction cited	**0**	There is no such step in sight, which was aimed at reducing discretionary powers of tax officials. More taxes add to the complexities in filing and assessing tax liability. It takes 47 tax

				payments per year in Pakistan, three times that in India, and almost double the hours.
10	Rationalizing sales tax by ensuring standard rate for all items	GST rate is not applicable on all items. Separate rates are notified from time to time for gas and petroleum products.	**0**	Heavy dependence on GST means the government uses it as a maneuvering tool, when in trouble. Fluctuation most obvious and frequent in petroleum products, that offers the easiest revenue avenue. Changes are frequent because of the political impact of petroleum prices.
11	Broadening scope of sales tax	Sales tax imposed on import of raw materials and inputs to be consumed in factories/industrial units located in the Federally Administered Tribal Areas	**2.5**	The indirect taxation system required a major overhaul. The GST needs to be brought to one level in all provinces, and be reduced by at least half of the current rate, for better results, and to discourage under invoicing incentives.
12	Improving self-assessment and audit compliance		**2**	Compliance costs are high, paving way for tax evasion. Better enforcement by the FBR required to keep a lid on under invoicing. Procedures must be made easier, with built-in incentives and a sense of equitable taxation amongst taxpayers.
13	Regulatory duty on non-essential imports	Regulatory duty imposed on import of 36 new products. Rates on 240 items hiked in a fresh move to curtail rising trade deficit of the country	**5**	Government has tried to limit imports of non-essential and luxury items. But the impact on overall trade deficit is limited, as a sizeable share of such imports have low demand elasticity, and the economy is increasingly becoming consumption driven.

INDUSTRY & TRADE				
	Agenda Target	**Status**	**Score**	**Comment**
1	Opening up markets to increase regional trade	Many initiatives such as TAPI, CASA undertaken as well as new FTAs with several countries in progress. CPEC is also poised to play a positive role in regional trade	**6**	Most FTAs have resulted in worsened trade balance with partnering country. Detailed and careful reevaluation of all FTAs is a must. The Pak-China FTA needs another look, and Pakistan must do better than the previous time, given CPEC related trade is expected to grow exponentially. Pakistan must find ways to look beyond import substitution and opt for value added exports.
2	Making ample credit available to private sector	Advances to private sector grown by 20% over October 2016. Signs of ending of crowding out	**8**	Loans to private sector business continues to remain strong, growing 18% YoY as on Feb 2018. Growth in government borrowing had been reduced to 10% YoY by Feb 2018. Ample liquidity is available for private sector. Improved law and order and energy situation have resulted in more private sector credit.
3	Industrial manufacturing growth to be taken to 7-8%	LSM growth stood at 8.7% YoY in October	**10**	Large Scale Manufacturing continues to flourish. Bulk of improvement comes at the back Cement and allied construction in the wake up of CPEC. Petroleum production is also on the rise, but may suffer in the future, due to low FO demand. Auto sector growth story goes on. The worrying sign is in the textile sector, which has remained flat, having the single highest share in LSM production.
4	Reforming tariffs to eliminate anti-export bias	Scope of RD expanded to include 136 new items	**0**	Pakistan continues to sit low on the global trade tariff reforms map. Pakistan's mean tariff rate is 10%, according to World Bank Integrated Trade Statistics. The average rate has worsened from 9% in FY09-13, to 10% in FY14-FY17. Pakistan's sits lowest in the region on overall Trade Restrictiveness Index with a score of 0.07, where the lowest possible score is zero.
5	Creating industrial	Land acquisition/allocation is	**5**	CPEC has provided the much needed impetus to the

	parks for large and small industries	complete for 5 of the 7 priority SEZs under CPEC which caters to under-developed areas in KPK and Balochistan.		otherwise underperforming National Industrial Parks.
6	Developing clusters for industries	No development	**0**	The progress has been stalled in most cases of industrial clusters, outside the CPEC ambit. Ministry has not been able to attract investors or complete cluster studies.
7	Incentives for MNCs operating in Pakistan	Corporate taxes have been brought down, but the Super tax was imposed (4% on income of banking companies, 3% for others). Evidence of other incentives outside CPEC not available.	**3**	Most MNCs have spelled displeasure over tax policies. The high tax incidence on corporate and manufacturing sector irks many MNCs. Unfavorable pricing, duty structure, and in some cases, stubborn pricing policy have resulted in MNCs leaving or threatening to leave the country. The loss in such a case is well beyond the one-time loss, as it also creates a vacuum in technology transfer and superior industry practices.
8	Incentives for MNCs expected to invest in export oriented industries	Pakistan will bear 50% of the mark-up cost of loans that investors will take for investment in CPEC SEZs. This support will be provided by the provinces where the SEZs are located	**5**	The policy seems attractive on paper, and the recent Gwadar Expo helped attract potential investors in the SEZs. Export oriented industries have not yet been set up, as most new industrial expansions have been based on internal consumption and import substitution.
9	Intensifying participation in regional cooperation forums like SAARC and ECO, including FTAs and PTAs	Pakistan is vying to host the 19th SAARC Summit in Islamabad. Last year the summit had to be cancelled after India backed out over a diplomatic row	**5**	Relationship with India will remain the single largest determinant of where Pakistan's regional trade goes. India trades twice and thrice as much with Sri Lanka and Bangladesh respectively that it does with Pakistan. Lack of competitiveness, border control and tariff issues, have also resulted in falling exports to Afghanistan. There is an urgent need to enter new FTAs on more equitable grounds, than continuing to being a dumping ground for all trading partners. Pakistan's regional trade connectivity indicators are the worst in the region, and need immediate focus.
10	All exports will be sales tax free	Five sectors benefit from zero-rating facility. Sectors include textiles, leather, surgical goods, sports goods and carpets	**5**	All exports, except those via land route to Afghanistan, are zero rated. Government has also issued SROs on zero rating of sales tax on import of five key export oriented industries, only for export receipts.
11	Export-Import Bank will be set up	Achieved	**10**	The bank has been set up, but is not operational. The Governor SBP was seen making a resolve in March 2018 to make the bank operational, as it faced serious capitalization issues. Lot more efforts need to be put, both in terms of injecting financing strength and technical working capacity.

STATE OWNED ENTERPRISES' REFORMS				
	Agenda Target	**Status**	**Score**	**Comment**
1	Appointing independent and professional boards	No examples of appointment of independent and professional boards in SOEs are available.	**0**	In some DISCOs, professional heads were appointed, but the reforms did not go beyond the first step. There are no buyers for ailing SOEs, as potential investors were looking for much cleaner and better performing SOEs. The result is a never ending drag on the fiscal deficit.
2	Identification and ensuring the completion of privatization process within the assigned timeframe	No privatization carried out during July-December 2017 or during the tenure of PML-N.	**0**	Privatization and restructuring of key loss-making PSEs have been largely on hold. The lack of political will continues to be the biggest hurdle. Even the restructuring did not take place, barring a couple of appointments in two DISCOs. The combined accumulated losses of PIA, PSM, and power sector had reached PKR1.2 trillion or 4% of GDP.
3	PIA will be transformed into a profitable and reputed airline of the region	Provisional figures for June 17, available with the SBP show debt of PIA at Rs. 122.4 billion; YoY increase of 22.65%.	**0**	Accumulated losses reached $4 billion. Yearly loss increased by 30% YoY to PKR45 billion. Transformation is nowhere to be seen, as the national flag carrier has suffered losses in terms of key routes and destinations. As late as March 2018, the cabinet in principle approved restructuring of PIA, which was right away rejected by the opposition.
4	Improving the operations of Pakistan Railways, such as by setting of autonomous Board	Some improvement in operations of Pakistan Railways is witnessed but giving autonomy is not on the radar.	**5**	Revenues have increased. New fleet has performed better. The PR is still not profitable, amassing PKR 32 billion in yearly losses.

About the Author

Zuhair Abbasi has a professional work experience spanning over 12 years, in the field of equity research, policy research, and financial journalism. Zuhair is currently a Research Fellow at PRIME and has been associated with BR Research, since its inception in 2009. In his role as a Senior Analyst at BR Research, Zuhair continues to extensively cover Pakistan's energy and financial sectors.

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Zuhair started his career as an equity analyst at Capital One Equities. He later served as Head of Research at Ismail Iqbal securities. Zuhair, on his credentials, has over a dozen financial models of various listed companies. He holds an MBA (finance) from the University of Karachi, and has keen interest in politics and political economy.

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ENERGY REFORMS PROGRESS
(manifesto only)

HITS

Energy Ministry
Net metering
Narrowly targeted subsidies
Tariffs according to system cost
Power dispatch according to merit order
Gas supply to power plants
Rationalization of energy tariffs
Blanket ban on CNG
Aggressive wellhead pricing
Coal and LNG terminals
Developing alternate renewable sources

MISSES

Upfront tariffs
Mandatory wheeling
NEPRA tariffs to be notified tariffs
Privatization of DISCOs
Reduction of T&D losses to under 10%
Recovery up to 100%
Ending of cross subsidy among DISCOs
Privatization of GENCOs
Eliminate circular debt
Tariff rationalization in gas sector
Decentralizing market for electricity

* Some variables have been marked differently from PRIME's tracking reports