Response to the IMF

October 19, 2015
DR HAFIZ A PASHA

The staff report on the eighth review of Pakistan's on-going program with the Fund was released a few days ago. This was followed by a long conference call by the Mission Chief, Harold Finger, in which he responded to questions from economic journalists of Pakistan. Thanks are due to Finger for his careful and patient response to each question. Also, the journalists must be commended for asking some very relevant questions.

Finger said that the performance under the Program has been 'broadly positive'. In the first seven reviews, cumulatively nine performance criteria have been missed and waivers obtained accordingly from the Executive Board of the Fund. Two criteria, out of the total of five criteria, were not met in the eighth review. These relate to the size of the fiscal deficit and government borrowing from SBP. Finger did not mention that two other criteria could have been missed but for appropriate adjustment in the targets. This demonstrates the understanding and support that is being extended by the IMF to Pakistan.

Finger was asked whether the size of the fiscal deficit in 2014-15 reported by the Authorities was being probed. The first issue related to the size of the 'statistical discrepancy' of Rs 178 billion in the budgetary numbers. The answer was that the Fund relies on the 'below the line' approach to estimation of the size of the deficit. This corresponds to the total financing from different sources. It was stated by him that 'there have been years where the statistical discrepancy was much larger'. Unfortunately, this is not factually correct. The statistical discrepancy of Rs 178 billion in 2014-15 is the largest ever. Last year, the Fund accepted a discrepancy of only Rs 61 billion. Such a large discrepancy does reflect relatively poorly on the budgeting systems and practices in the country and calls for improvements in public financial management.

Also, there is the issue of what sources constitute financing of the deficit. IPR, among others, has argued that receipts from privatisation are a financing, not revenue, item. In 2014-15, sale of HBL shares yielded a large amount of Rs 103 billion, which the Authorities have included in non-tax revenues as part of SBP profits.

Finger supported the view that privatisation receipts are a revenue item. He justified it on the grounds that receipts from privatisation of banks like HBL and UBL were treated in a similar way in the early 2000s and shown as part of the profits of SBP, the presumed owner of the shares. This again is not factually correct. For example, UBL's privatisation yielded Rs 12.4 billion in 2002-03. In the same year, profits of SBP were shown as only Rs 6 billion. Therefore, the receipts were not shown in the latter head.

There are other important reasons why privatisation receipts must be shown 'below the line', as follows:

I. According to the Privatisation Ordinance of 2000, all privatisation receipts, without exception, are to be shown to the extent of 90 percent as a source of reduction in federal debt and 10 percent for financing of poverty programs.

II. Every year the government of Pakistan, specifically the Ministry of Finance, has been receiving dividends directly from banks like UBL, HBL and ABL. This means that the owner is the GoP and not SBP.

One of the distinguishing features of the latest media interaction with the Fund is the deep concern shown by Finger on the state of the power sector, perhaps based at least partially on the latest Nepra report. He indicated that the circular debt has approached 2 percent of the GDP, almost Rs 600 billion. This is in sharp contrast to the number given recently by the Ministry of Water and Power of Rs 320 billion. Finger has rightly suggested that the circular debt should be treated as 'contingent liabilities'. Already Rs 200 billion of contingent liabilities are included in grants. This tends to imply that the annual flow of net borrowing by the Power Holding Company should also be included in the fiscal deficit.

Mention must be made of the humanity shown by Finger is recognising the plight of our farmers caused by the fall in commodity prices. He says that there is a need to help the farmers and 'that this is something close to his heart'. The Prime Minister has announced a comprehensive relief package for farmers, especially the small farmers. This package will require resources of Rs 121 billion from the budgets of both the Federal and Provincial governments, according to IPR estimates. It will need to be financed mostly by an increase in the fiscal deficit of up to 0.4 percent of the GDP in 2015-16. This may be acceptable to the IMF. On the textiles package, the indication is that an exchange rate adjustment may be the only option available.

An important question was asked relating to the anti-poor bias in the steps being under taken as part of the IMF program. Finger defended the position of the Fund by saying that the program includes two important measures of social protection. The first is the cash transfers scheme under the BISP and the second is the large subsidy to lifeline consumers of electricity. However, they were in place before the commencement of the Fund program.

The process of stabilisation under the IMF Programme has, in fact, imposed a significant burden on the lower income groups. This includes large regressive tax moves like enhancement in standard GST rate, levy of 50 percent sales tax on high speed diesel, rise in import duties on basic food items, imposition of a large regulatory duty on the import of wheat and sugar, etc. Further, development expenditures on basic social services have been cut back under the pressure for generating cash surpluses by provincial governments, as part of the reduction in the overall fiscal deficit under the program. Social indicators have generally stopped improving and, in fact, the literacy rate in Pakistan has fallen recently from 60 percent to 58 percent.

Finally, there is need for looking forward. The next staff review, the ninth, will take place in a few weeks. The first quarter of 2015-16 has been a disappointing quarter in terms of growth in exports, tax revenues, reserves, etc, as indicated by figures up to the last week of September. There is the likelihood that some performance criteria may not be met. As in the past, we look forward to the same understanding and sympathy from the IMF.

October 26, 2015

<u>SBP's Version on Article of Dr. Hafiz A . Pasha Titled 'Response to the IMF'</u>

Dear Editor,

Apropos Dr. Hafiz A. Pasha's article on ***'Response to the IMF'***, published in your esteemed newspaper on October 19, 2015. The article contains certain assertions with regard to accounting of privatization proceeds of public sector banks, which have no factual basis. To set the record straight, it is clarified that United Bank Limited was privatized in FY 2002-03 through Privatization Commission, by offloading 51% shares in the bank. SBP was holding 99.6% shares in that bank at the time of its privatization and, therefore, the transaction could only be executed by drawing down on the SBP shareholding in the UBL. SBP duly received the privatization proceed, net of transaction related expenditure as are authorized under the Privatization Commission Ordinance, 2000.

The learned writer appears to be under the impression that impact of entire amount of privatization receipts should have been reflected in the bottom line of the SBP' Profit and Loss Account for that year. In this regard, it is clarified that SBP maintains its books of accounts under the concept of accrual basis of accounting in accordance with international accounting standards as opposed to the cash/modified cash basis of accounting which is followed in the government. Accordingly, the bottom line of SBP reflected the net impact of privatization proceeds, net of cost of investment, privatization expenses and reversal of provision for diminution in value of investment. It is, therefore, inappropriate to trace the entire amount of privatization proceeds in the net profit of the Bank.

So far as the Habib Bank Limited transaction is concerned, it is clarified that during the FY 2014-15, 609.3 million shares were disinvested, out of which 595 million shares pertained to SBP holdings whereas remaining 13.7 million shares were owned by the Federal Government. Consistent with underlying ownership of shares, the sales proceeds of 595 million shares were received by the SBP whereas Federal Government was in receipt of balance amount. In accordance with Bank's financial reporting framework, the excess of net proceeds over the cost of investment was transferred to Government as part of SBP's surplus profit. The contention that it was departure from the previous transaction is factually incorrect and hence categorically denied. As a matter of fact, similar accounting treatment was accorded to all the previous transactions, including the sale of shares in Allied Bank Limited and United Bank Limited. It is further clarified that in all the years in which shares in above referred entities' were carried on the books of the Bank, dividend's receipts were duly received by the SBP and reflected as profit. As the Federal Government had its own stakes in these banks, over and above the SBP's shareholding, dividend receipts on such holdings must not be confused with dividends on SBP holdings, which were always reflected in its Profit and Loss Account in the relevant years.

(Abid Qamar)
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