

**Economic Developments in Pakistan  
and  
US-Pakistan Civilian Assistance**

**Presentation  
by  
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Washington DC**

**At  
Pakistan Club  
University of Chicago  
3<sup>rd</sup> May 2014**

# Outline

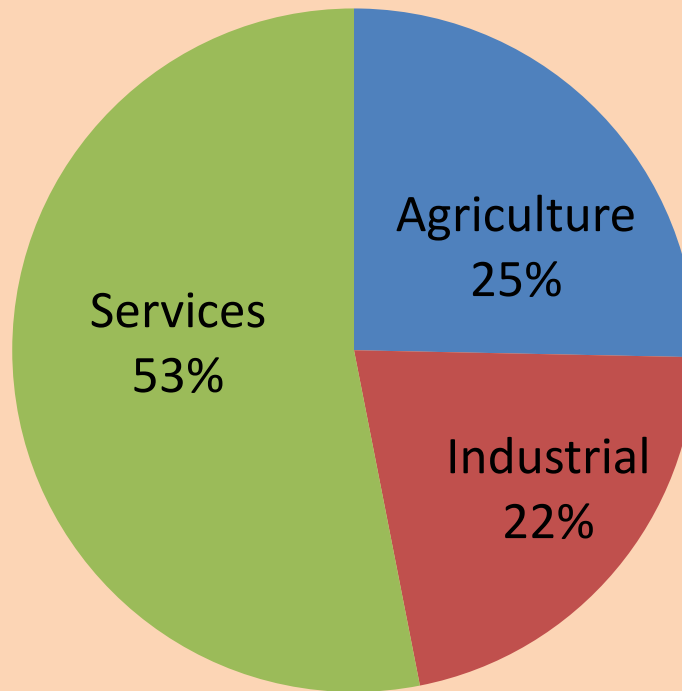
- Macro indicators of Pakistan Economy
- Economy at a Glance.
- Major Challenges faced in the economy
- Importance of Tax to GDP Ratio & FDI for the economy
- Energy Crisis
- Us Bilateral Assistance
- Pakistan losses due to war on terror.
- Tax Collection in historic perspective and paradigm shift
- Remedial measures and Recommendations

# M.A.T. Macro Indicators

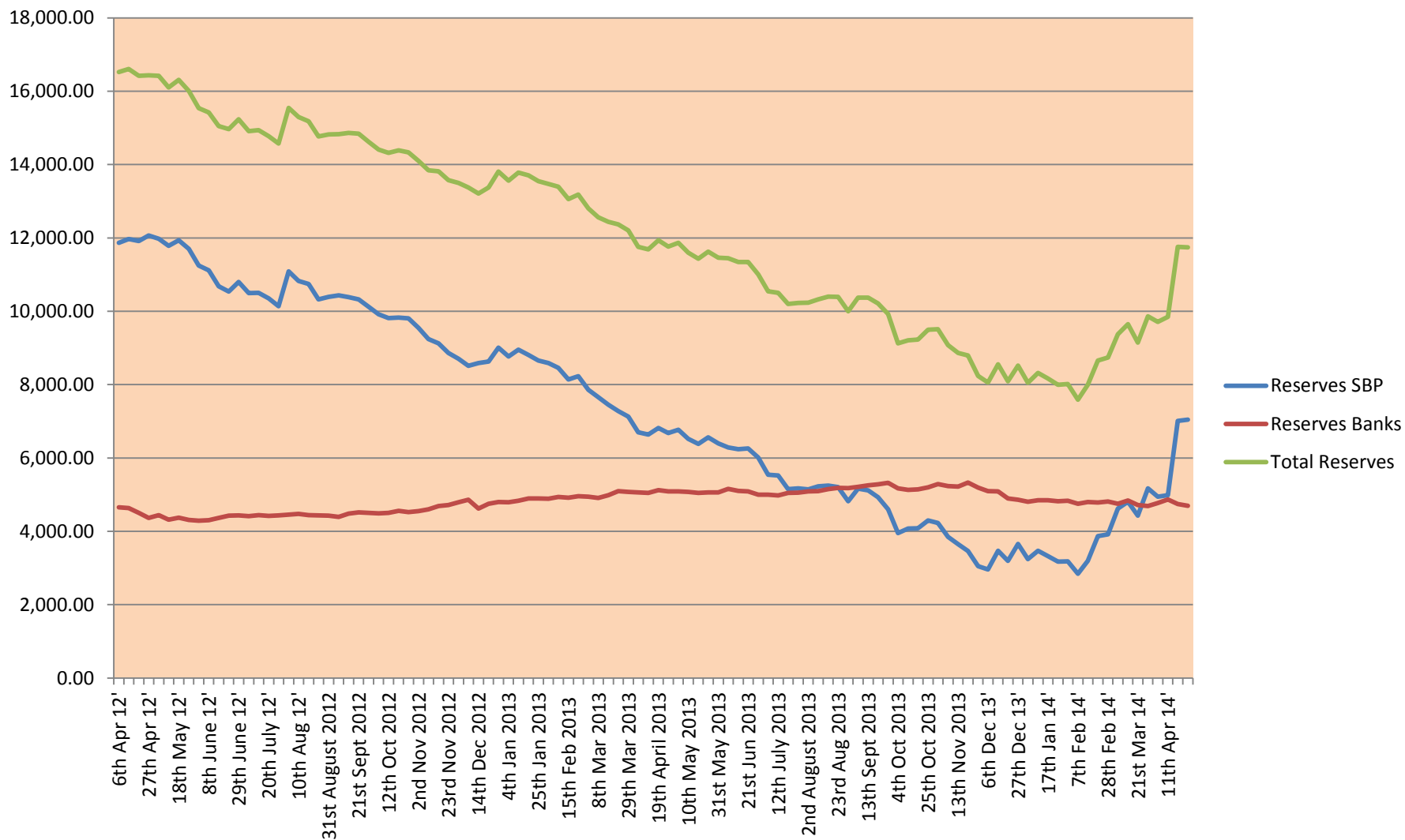
• <b>Exports</b>	\$ 25.37 Billion
• <b>Imports</b>	\$ 41.49 Billion
• <b>Remittances</b>	\$ 14.92 Billion
• <b>Foreign Direct Investment</b>	\$ 1.47 Billion
• <b>Foreign Private Investment</b>	\$ 41.0 Billion
• <b>F.B.R. Collection (July-Apr)</b>	RS. 1671 Billion
• <b>Inflation</b>	9%
• <b>Current Account Deficit</b>	1.0% of GDP
• <b>Fiscal Deficit</b>	6.3% of GDP
• <b>Per Capita Income (2011-12)</b>	US \$ 1372
• <b>Investment to GDP Ratio</b>	12.5 %
• <b>Tax to GDP Ratio (2011-12)</b>	9.0%

# Economy at a Glance

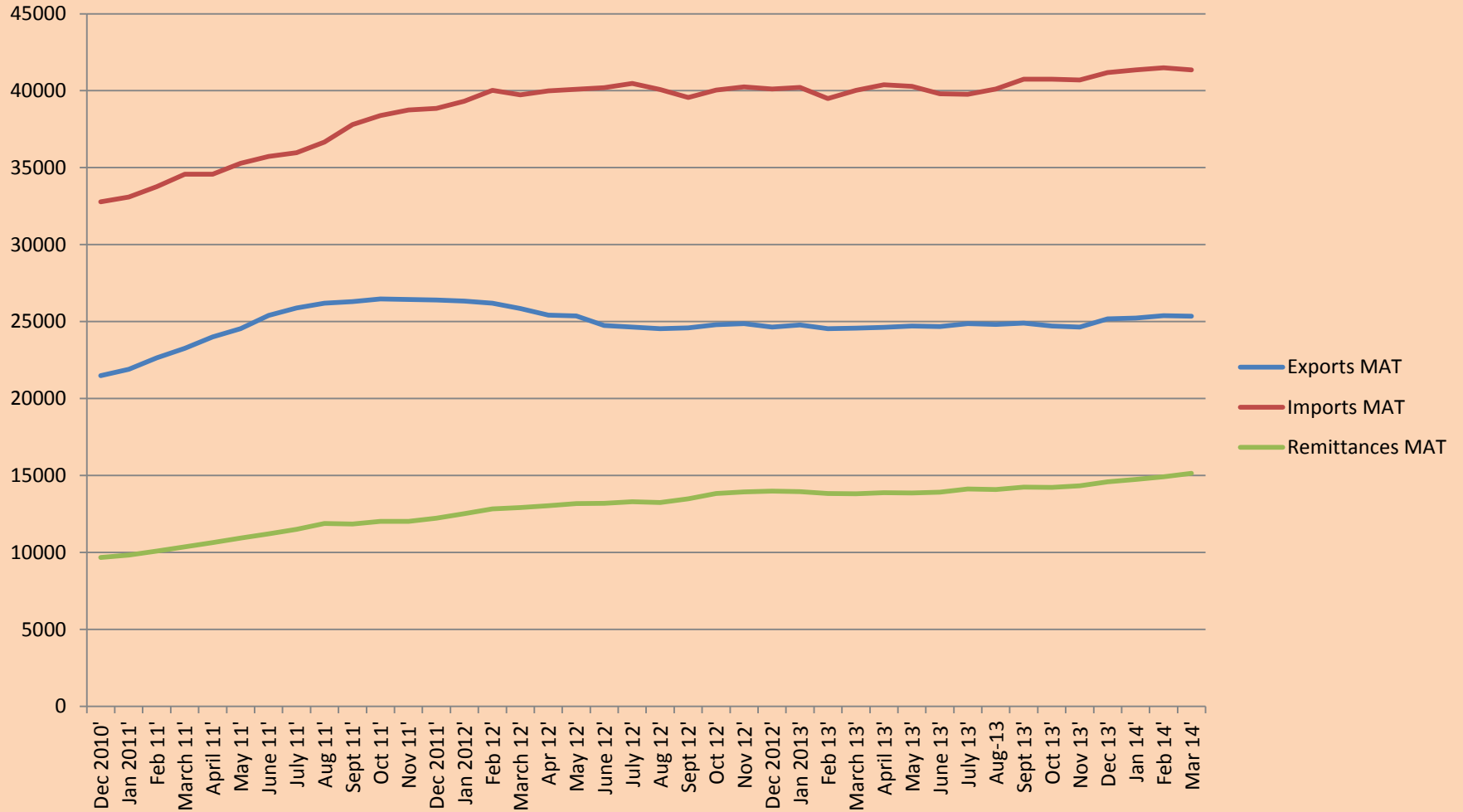
## Major Sectors of Economy



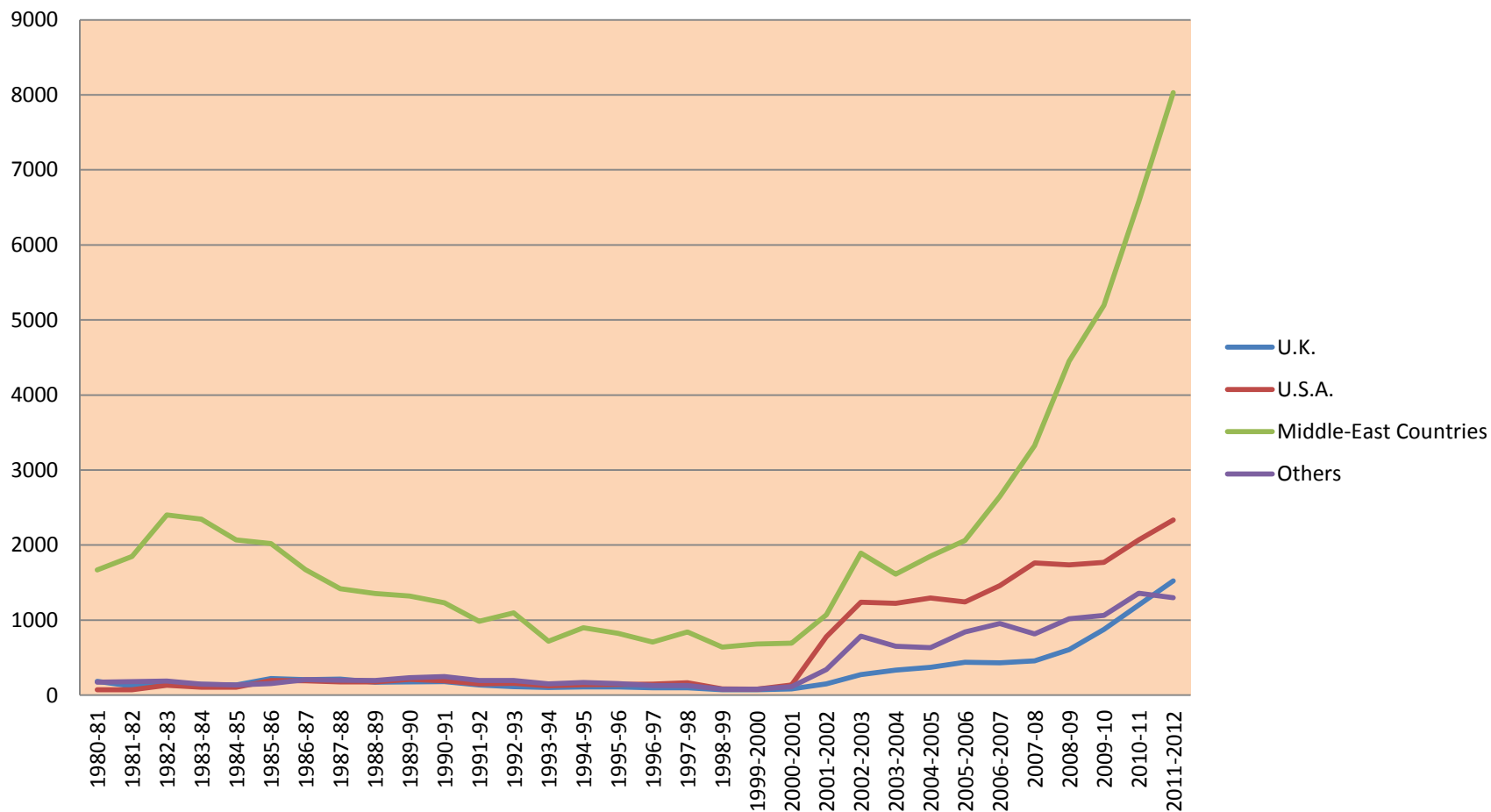
# Forex Reserves



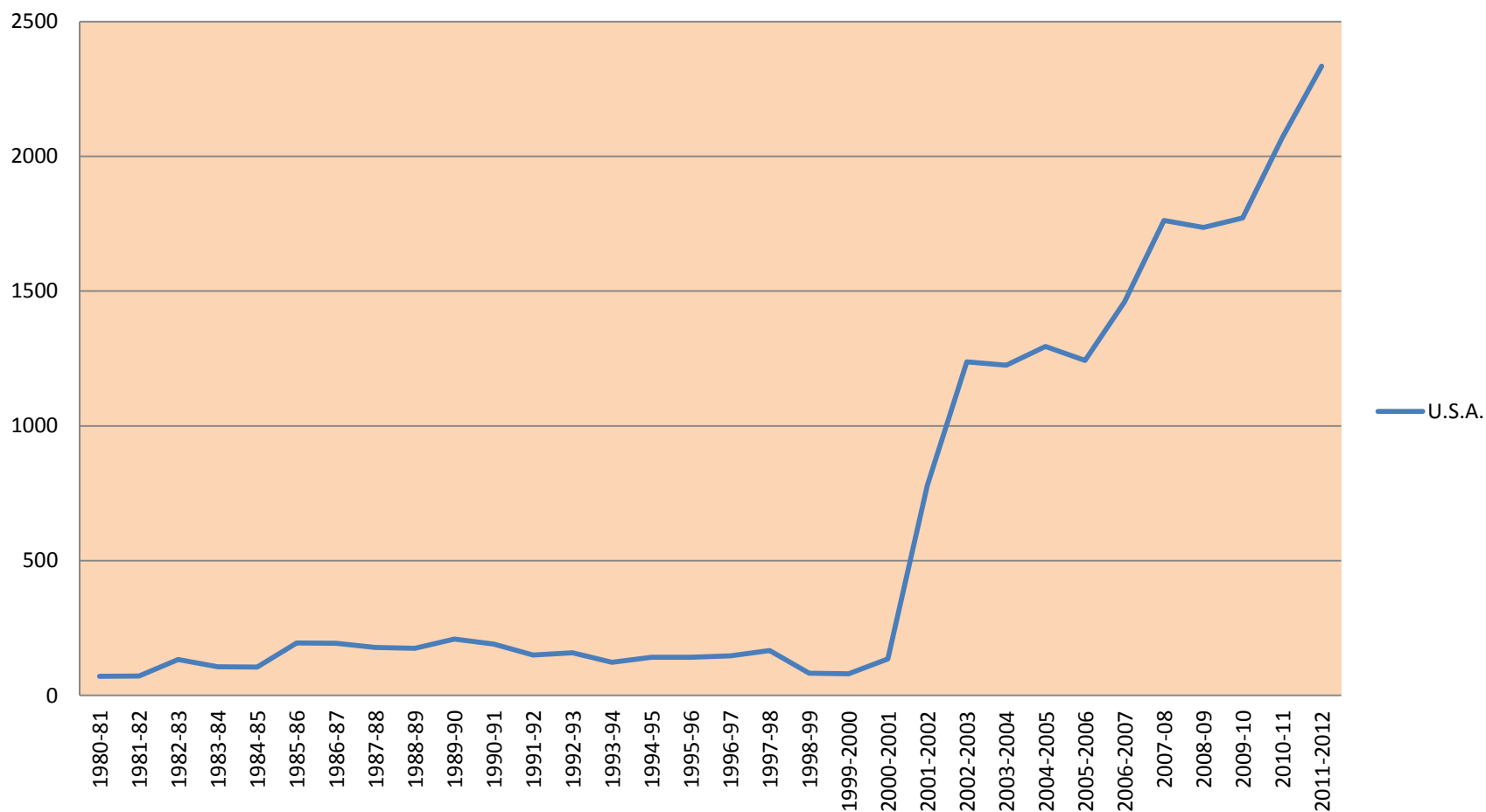
# Imports, Exports and Remittances



# Home Remittances by Region (USD millions)

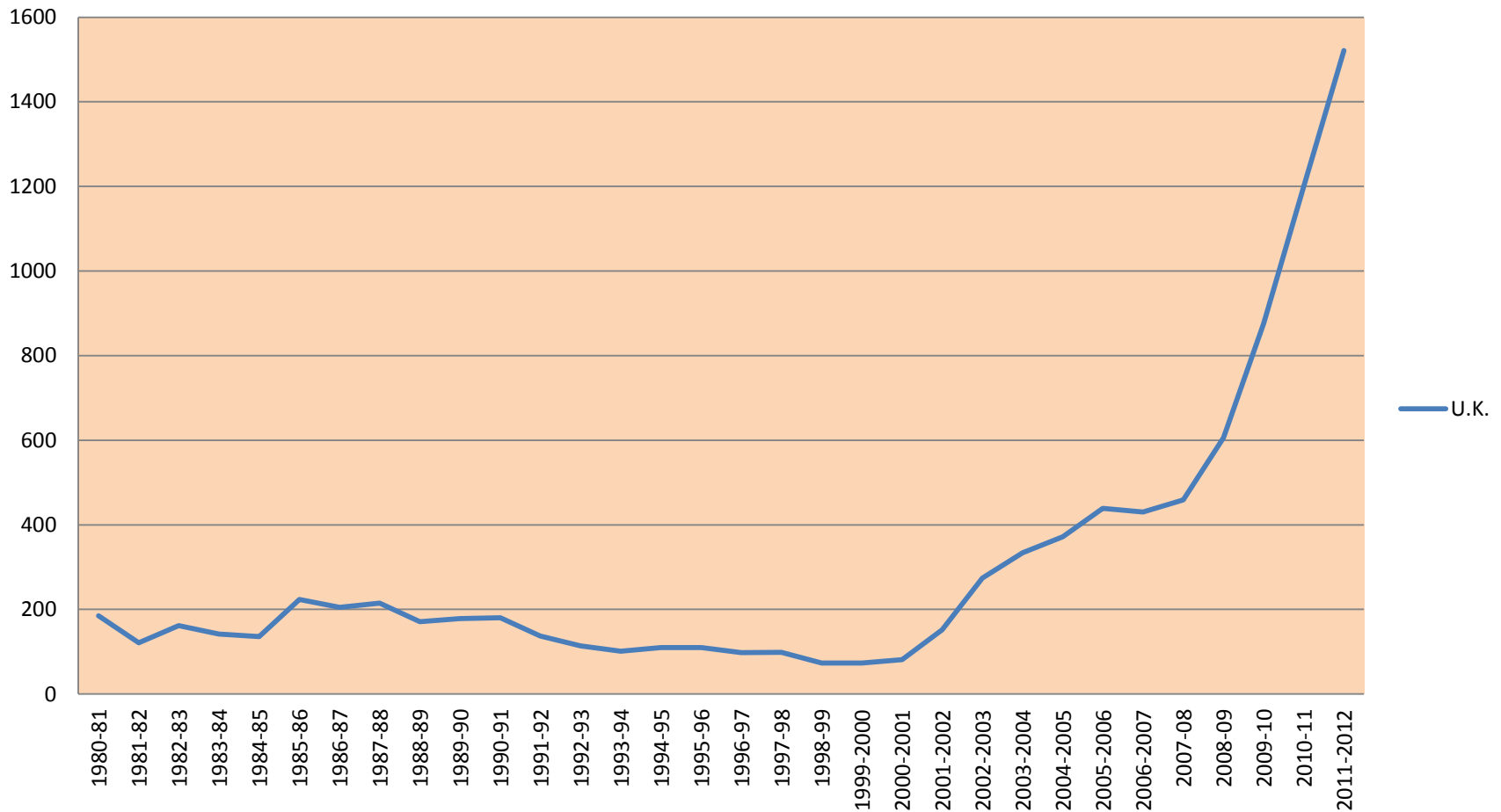


# Home Remittances from U.S.A. (USD millions)

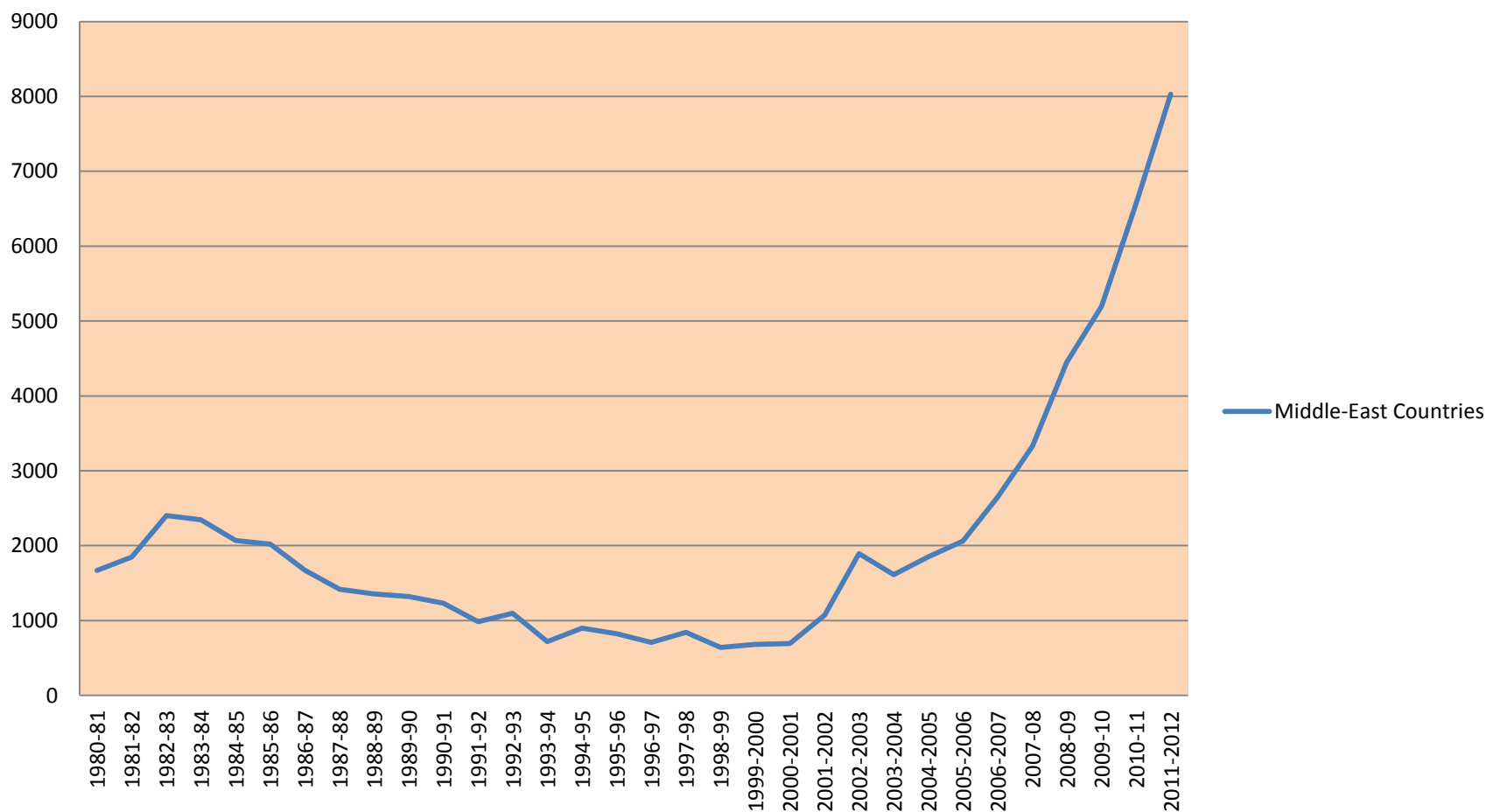




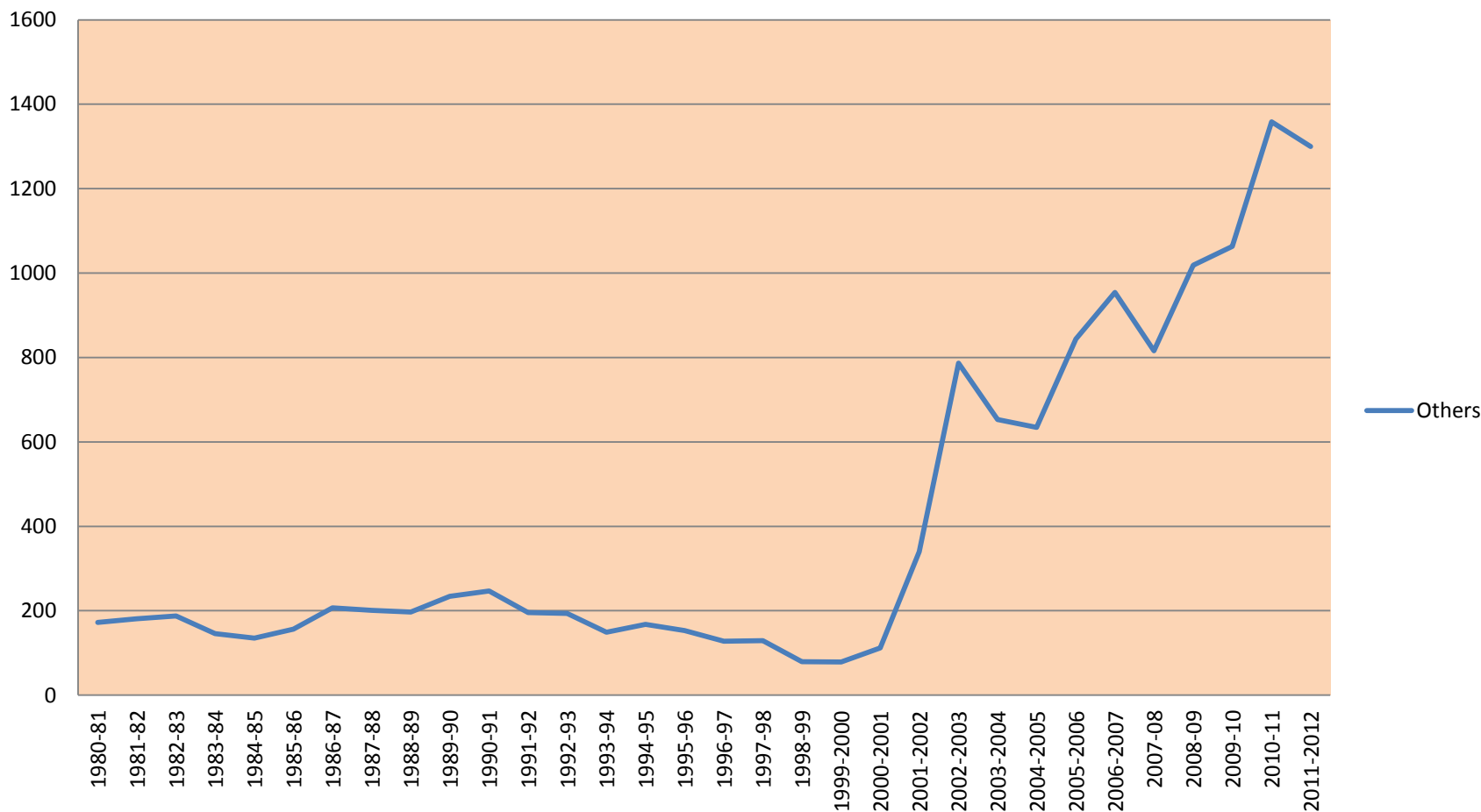
# Home Remittances from U.K. (USD millions)



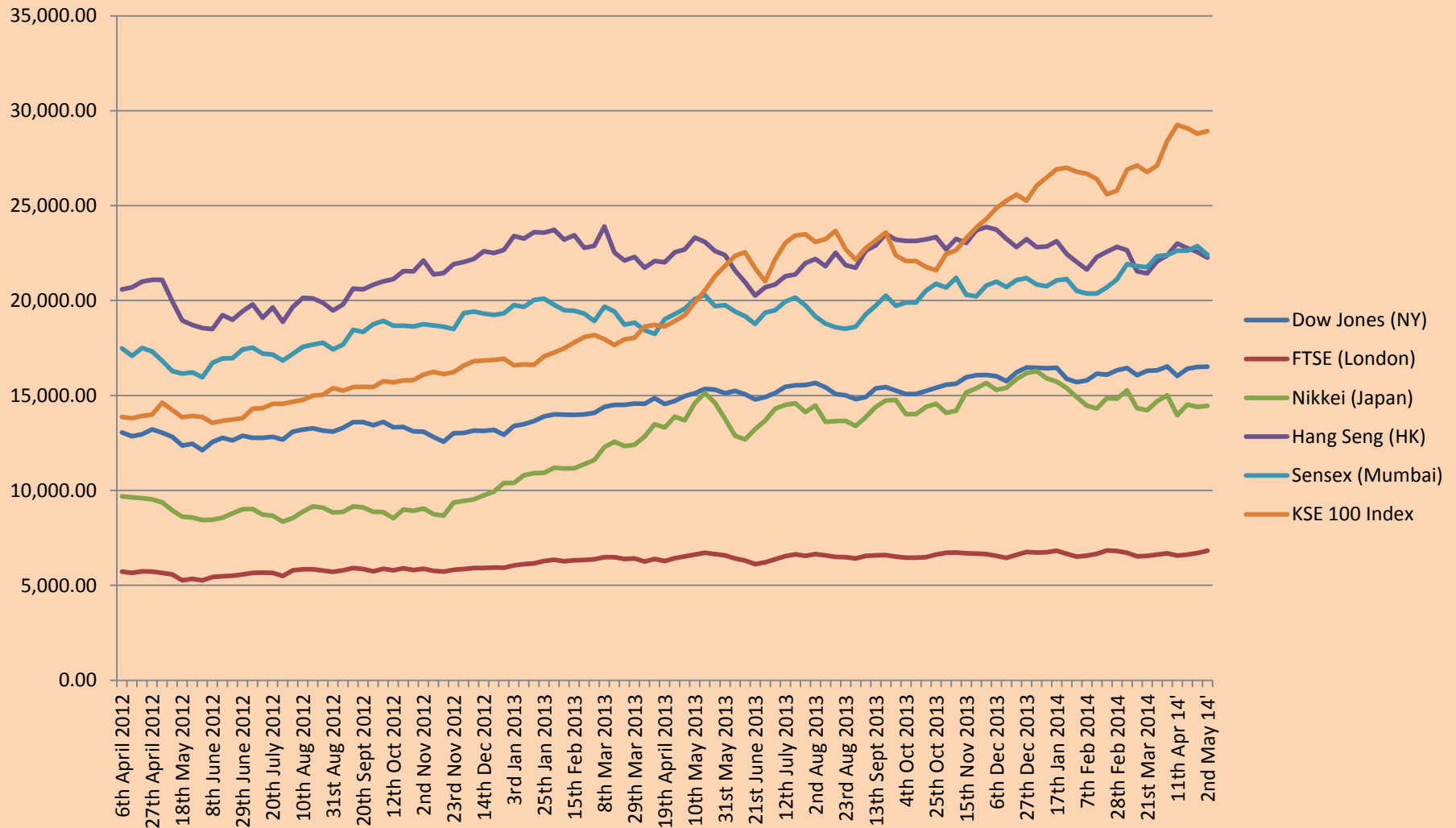
# Home Remittances from Middle-East Countries (USD millions)



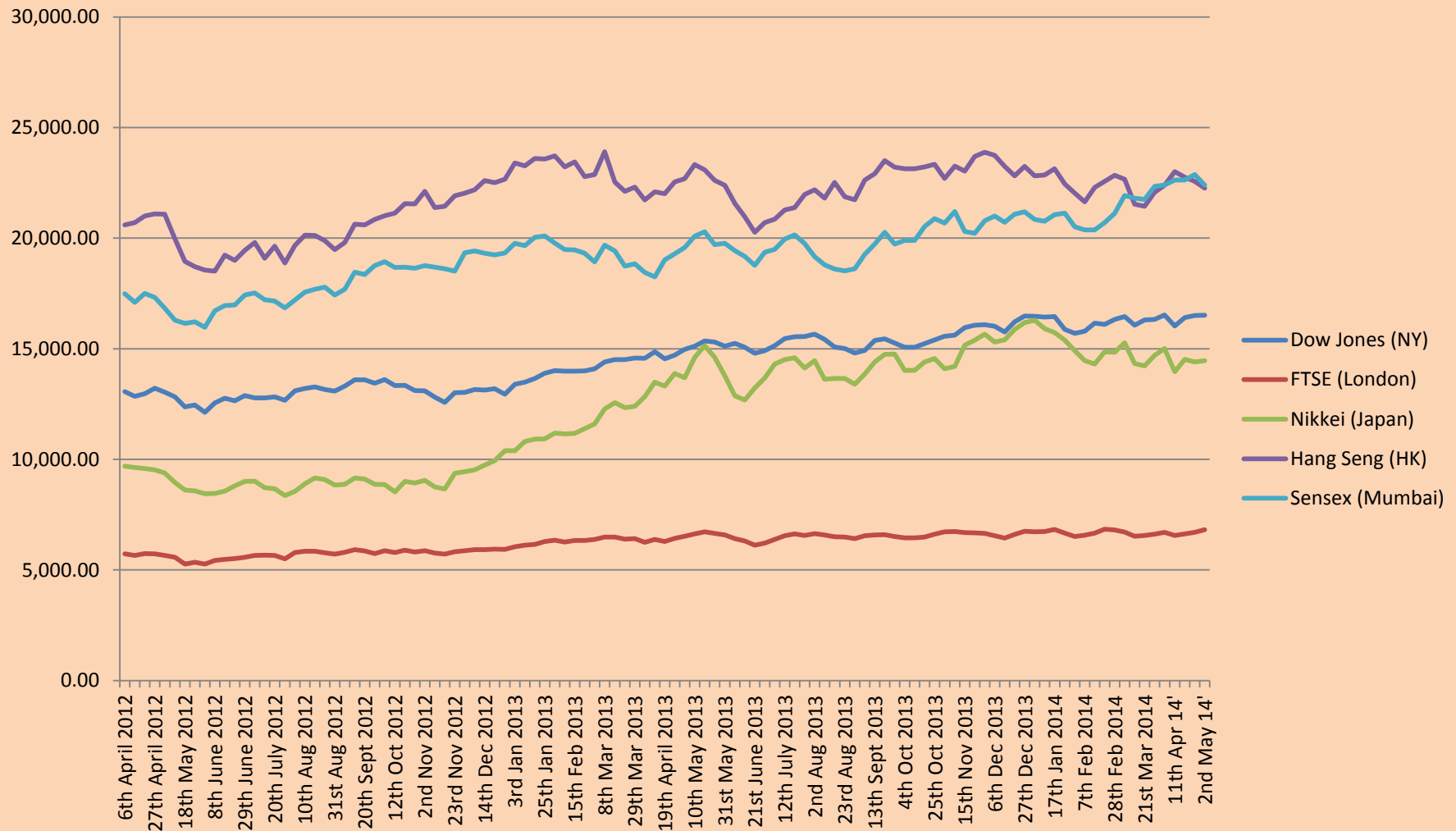
# Home Remittances from Others (USD millions)



# Stock Markets with Karachi Stock Exchange



# Stock Markets without KSE



# Major Issues in Pakistan Economy

- Pressures on Capital Account
- Declining FDI
- Declining Tax to GDP Ratio
- Over reliance on Monetary Policy
- Excessive domestic borrowing
- Extremely volatile internal and external geo-political environment
- Energy shortages
- Increase in Poverty and unemployment rates

# Euro Bond Issuance

- Last issuance in 2007
- Offered \$500 million
- Offers Received \$3.8 billion for 5 years tenor
- \$3.1 billion for 10 years tenor
- Government accepted bids for \$2 billion (\$1 billion each for 5 year and 10 year tenor)
- In view of tapering of Quantitative Easing and the large absence of Pakistan from Bond Market its outstanding

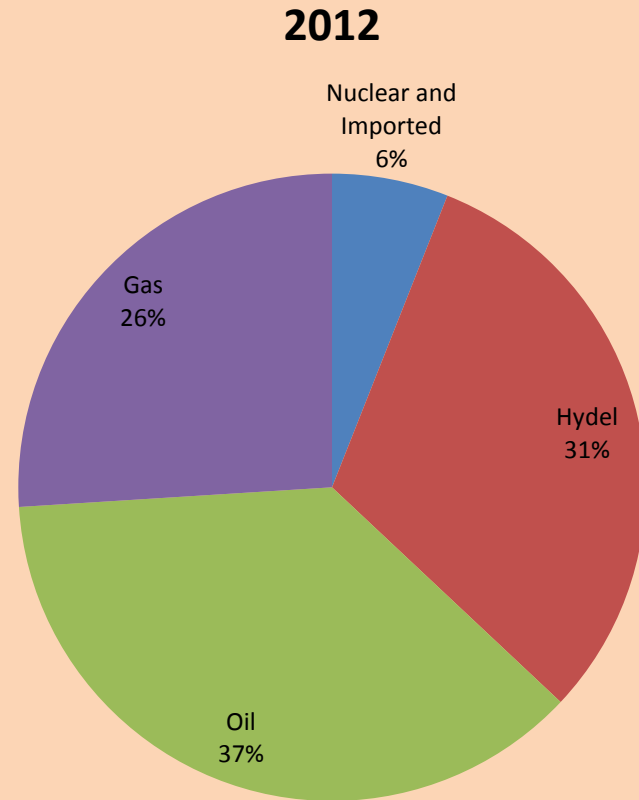
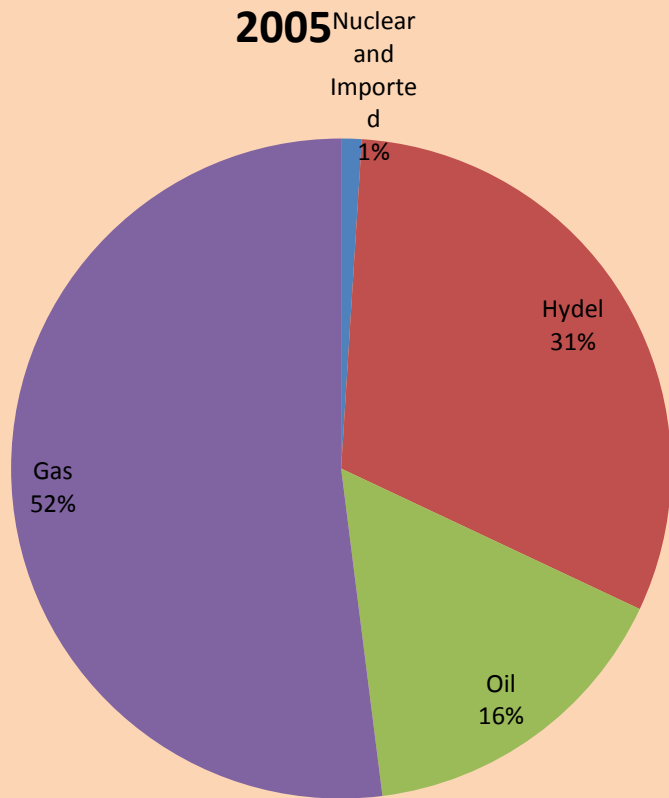
# Historic May Day at World Bank

- On May 1, 2014 World Bank approved \$1 billion for 2 Development Policy Credit Loans which is endorsement of Government Policies
- Also on the same day World Bank approved Country Partnership Strategy for Pakistan for 2015-19 period during which it will extend assistance worth \$11 billion
- Lastly on that day World Bank approved IFC's proposal to invest in 3 Gorges subsidy for Pakistan which will invest in energy and infrastructure projects



# High Cost Unfavorable Energy Mix

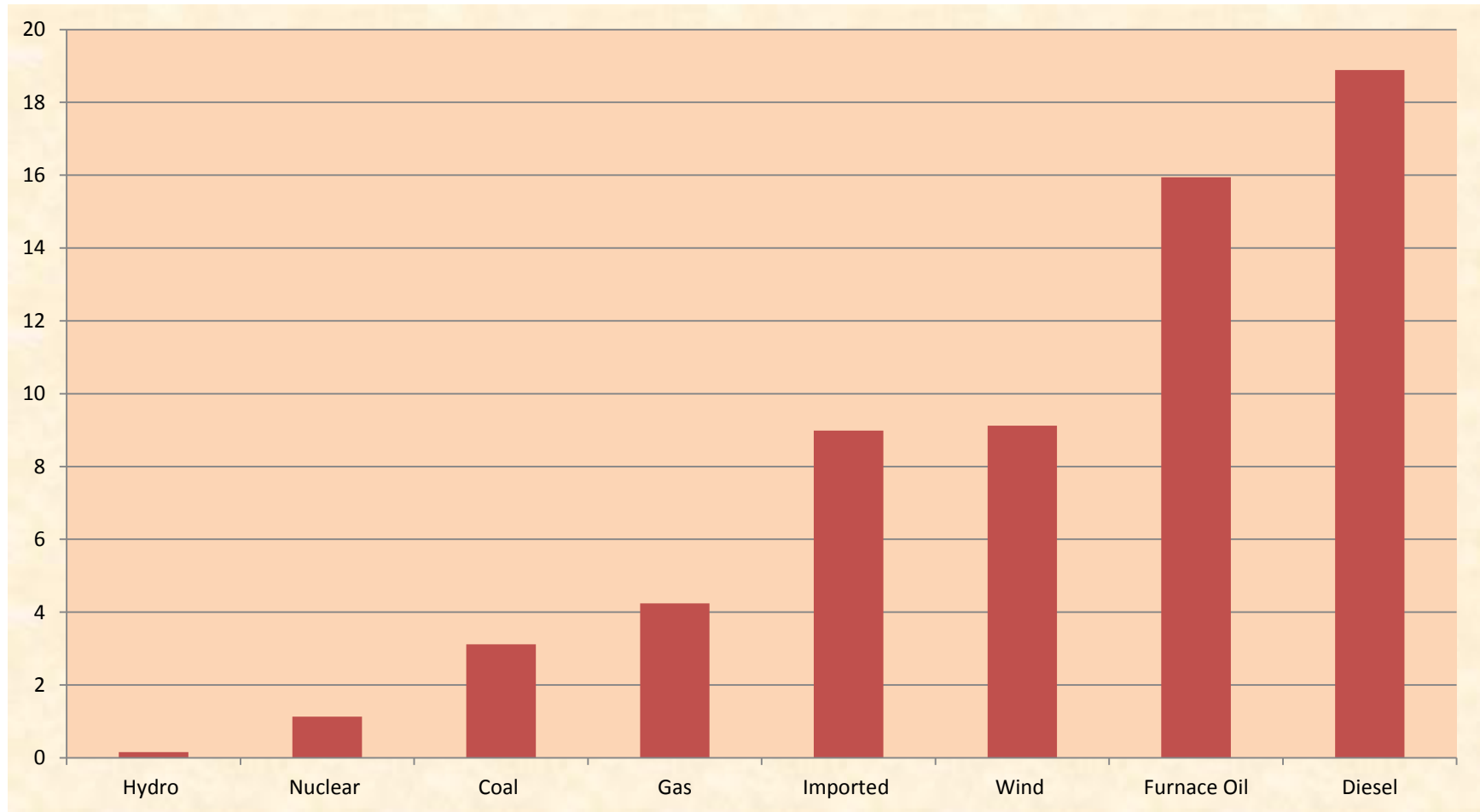
## Electricity Generation by Power Type 2012 vs. 2005



# Oil: Very Expensive Source of Electricity

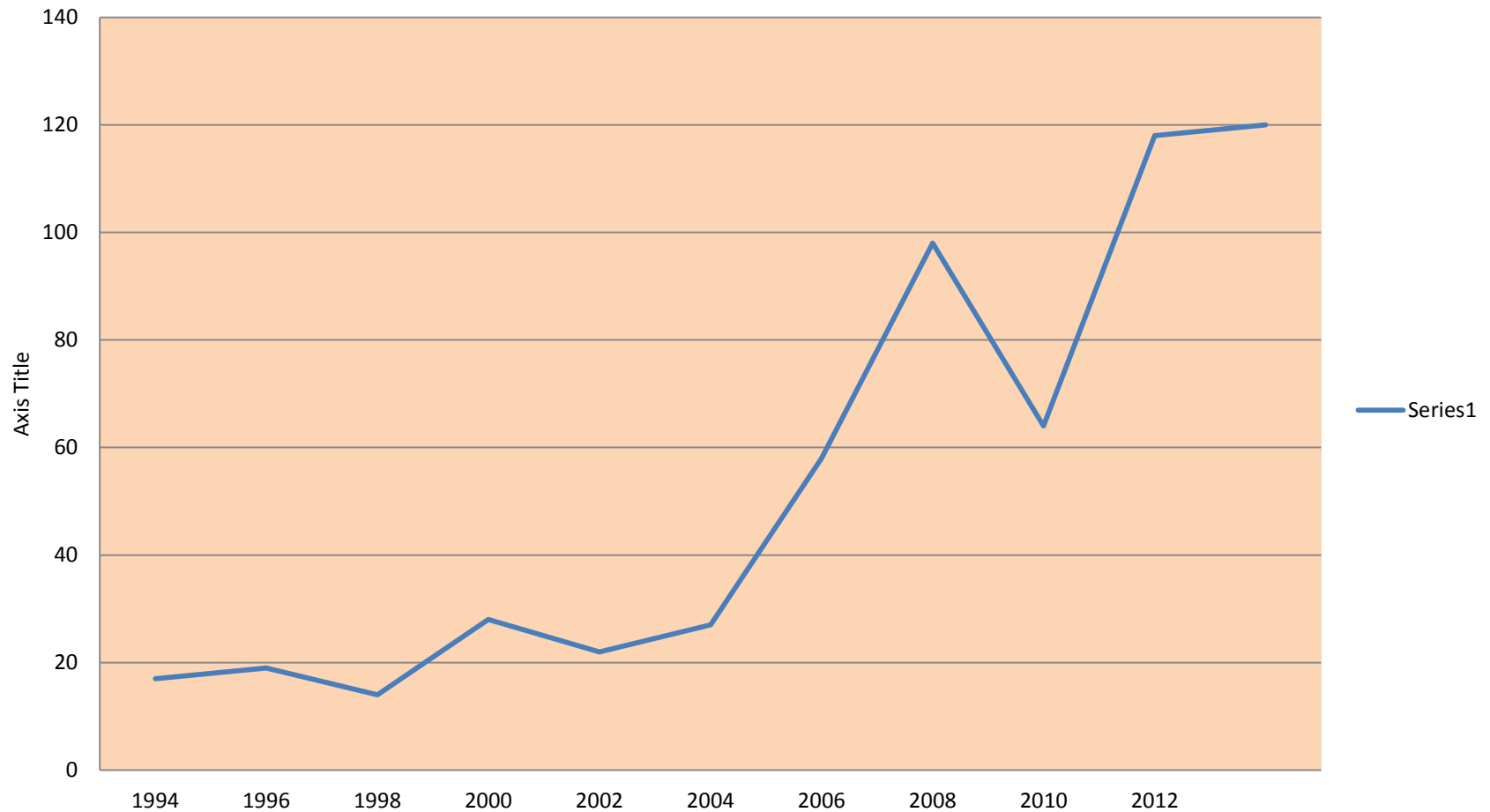
Average Cost of Electricity by Power Type

Rupees per kWh 2011-12

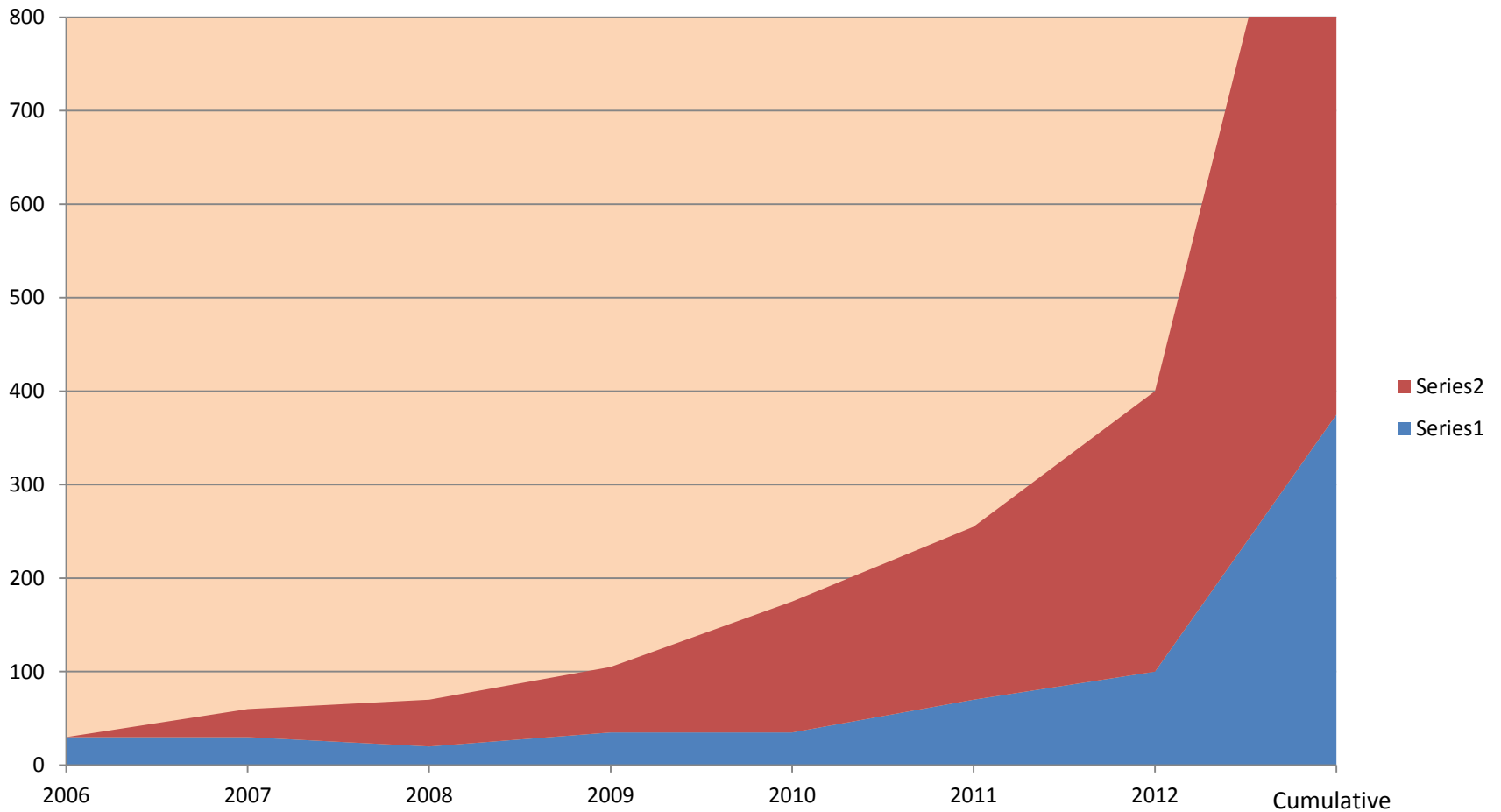


# Rising Oil Prices 1994 – 2012

## Brent Crude US \$ Per Barrel



# Growth in Circular Debt 2006 to 2012



# Steps taken by the New Government

- Clearance of Circular Debt of over Rs 500 billion or \$5billion to increase electricity in the grid
- Efforts to improve fuel mix: Approval of ADB for Conversion of Jamshoro plant to Coal. Also Gadani Coal Park Project
- Rationalization of tariff to avoid recurrence of Circular Debt and invite new investment in the sector
- Approval of Dasu Hydropower Project, Land Acquisition for Diamir Bhasha Dam, increase in pace of Nandipur, Neelum Jhelum and Tunnel IV of Tarbela Dam
- Approval of CASA 1000 Project

# Steps being taken/under consideration in Gas Sector

- Import of LNG
- Increase of Wellhead price to invite FDI in the sector
- Mapping of gas reservoirs with the help of US experts and USAID to explore new wells
- Iran Pakistan Gas Pipeline to procure cheap gas and improve regional integration
- Turkmenistan, Afghanistan, Pakistan India gas pipeline to acquire cheap gas and connect Central and South Asia

# Foreign & Local Investment

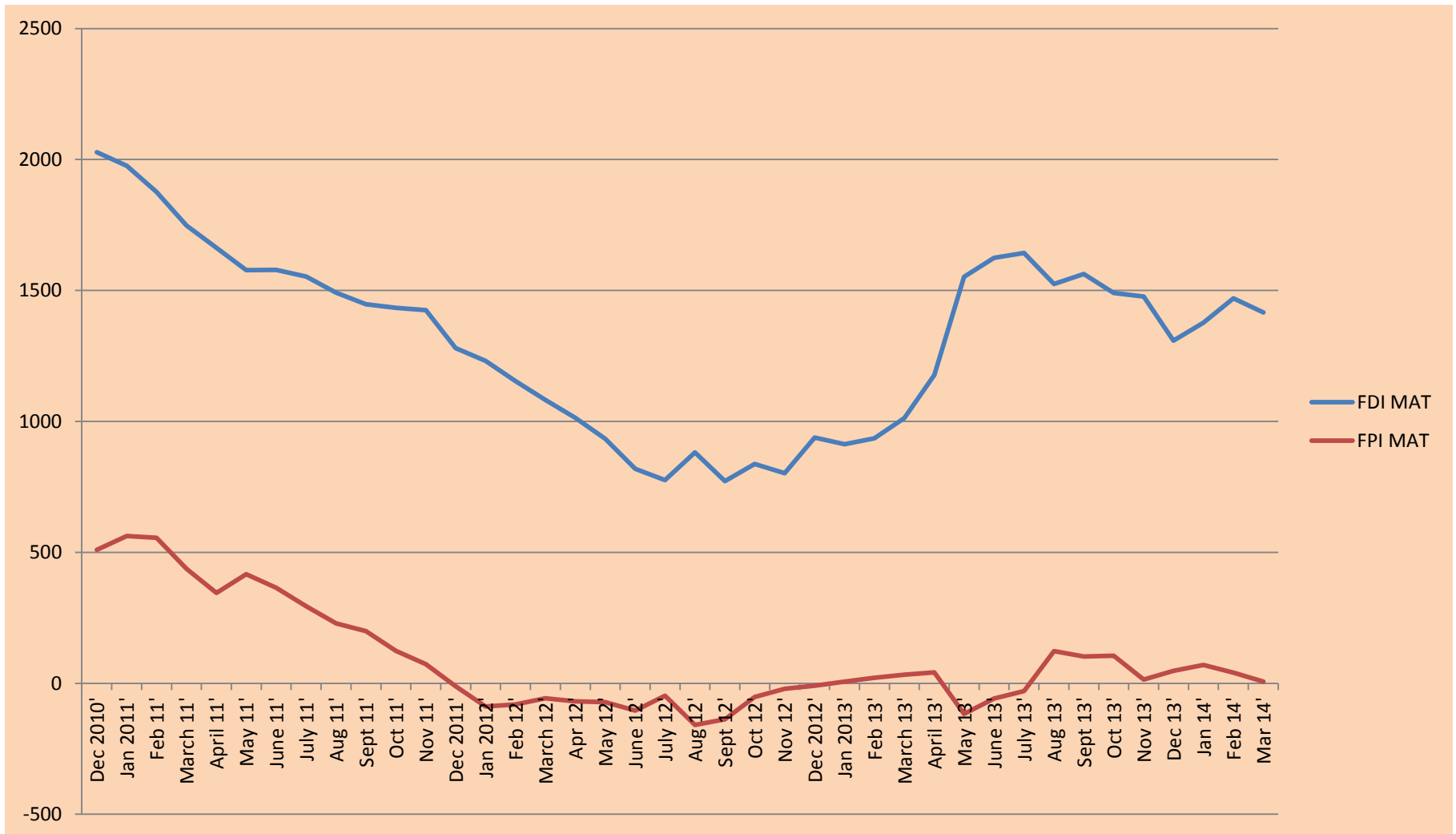
- The GDP growth rate of below 4% over the past four years is highly correlated with declining real private investment expenditures and alarming increase in unemployment.
- This coupled with severe energy shortages is negatively affecting the utilization and expansion of the economy's productive capacity. The economy has just passed the low-growth-high inflation equilibrium. Although inflation has slid into single digits the lack of investment is hampering growth in economy
- **But why is investment not forthcoming?**

# Foreign Investment shying away?

- FDI goes up only when the local investor comes forward and takes the lead in support of which foreign investors bring finances for viable projects.
- The following chart will show that the FDI has come down from \$2 billion in 2010 to less than 1 Billion in 2013
- The decline in DR during 2012-13 only marginally increased private sector lending.
- There are however other determinants of Foreign Direct Investment which are discussed in next slide



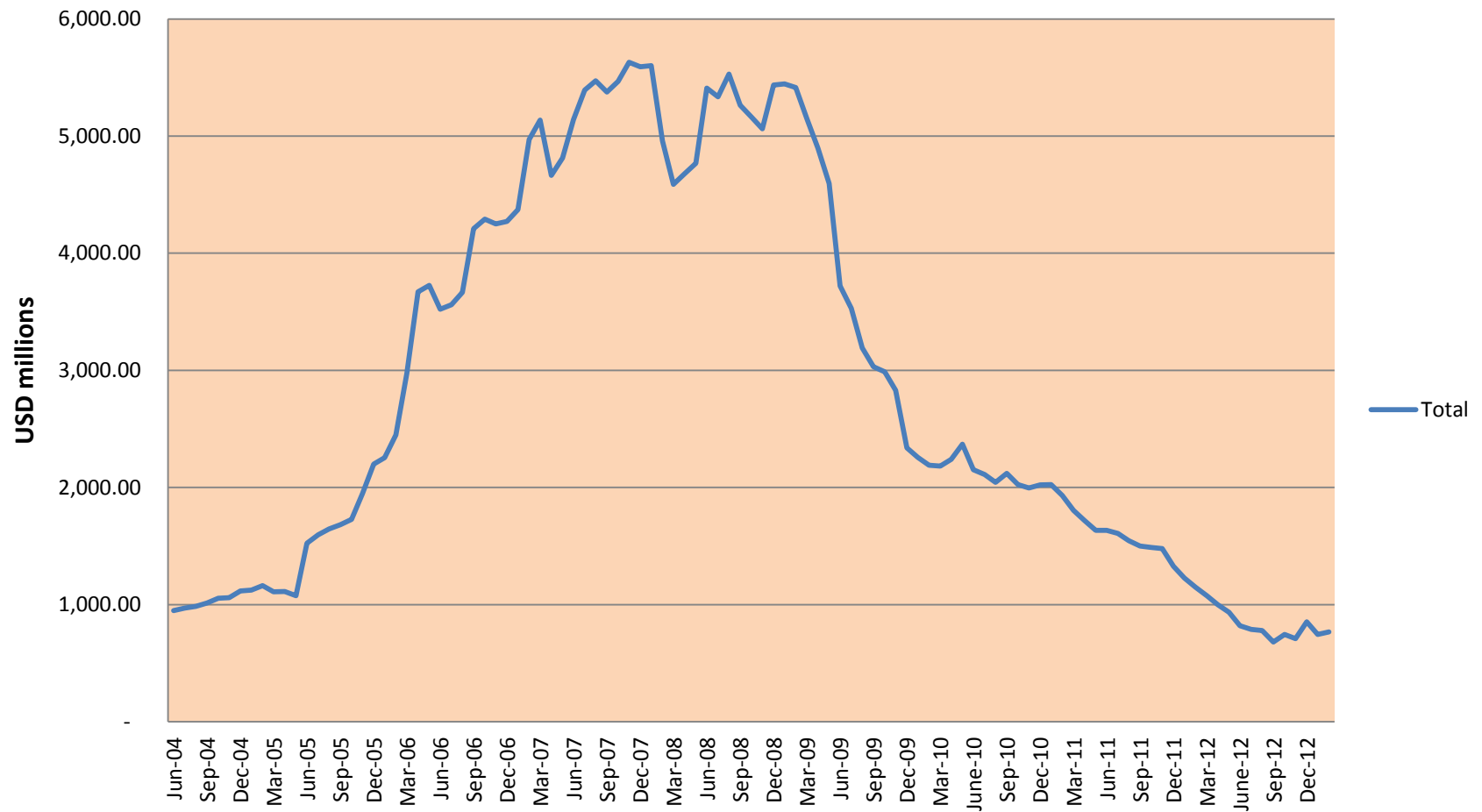
# (MAT) FDI & FPI



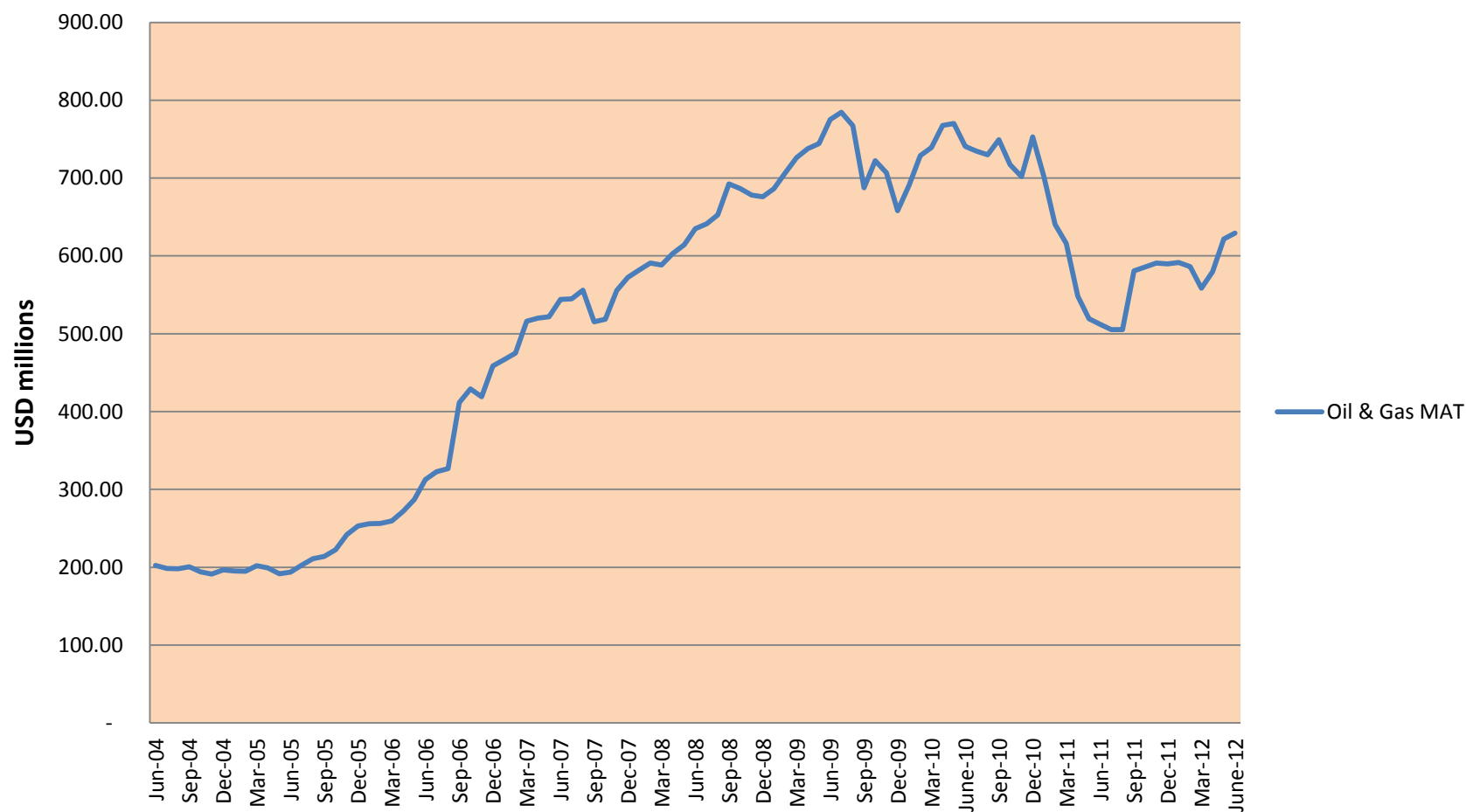
# Determinants of FDI

- According to the World Bank working paper "The Economics of Foreign Direct investment Incentives" by Blomstrom and Kokko, the five major determinants of foreign Investment inflows are:-
  1. Market size
  2. Political and macroeconomic stability
  3. Suitable skill level of the host economy
  4. Availability of adequate infrastructure and
  5. Trade policies
- Pakistan is attractive on all factors but the only impediment faced by Pakistan is security environment which is primarily because of War on Terror

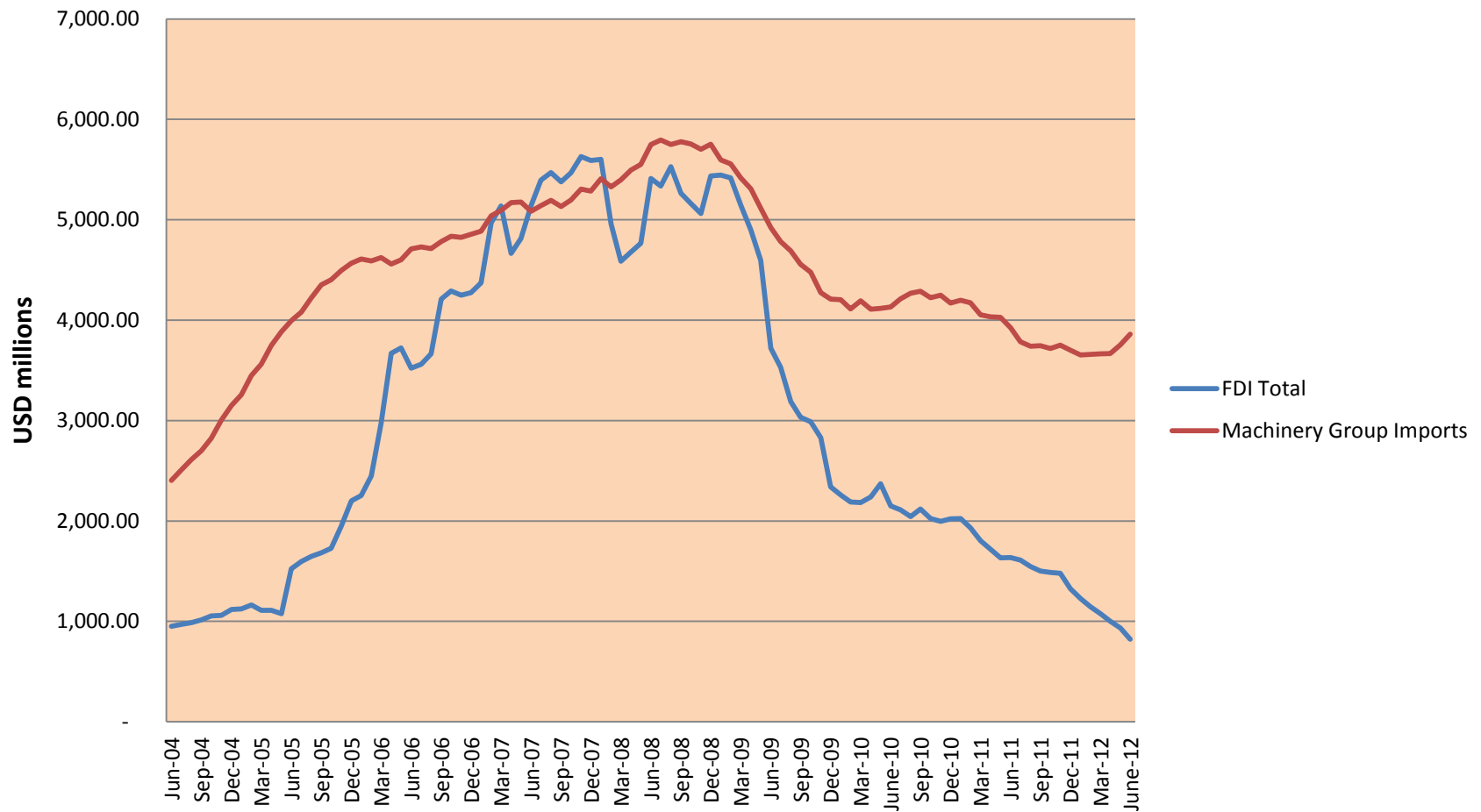
# Total FDI (Jun-04 to Feb-13) MAT



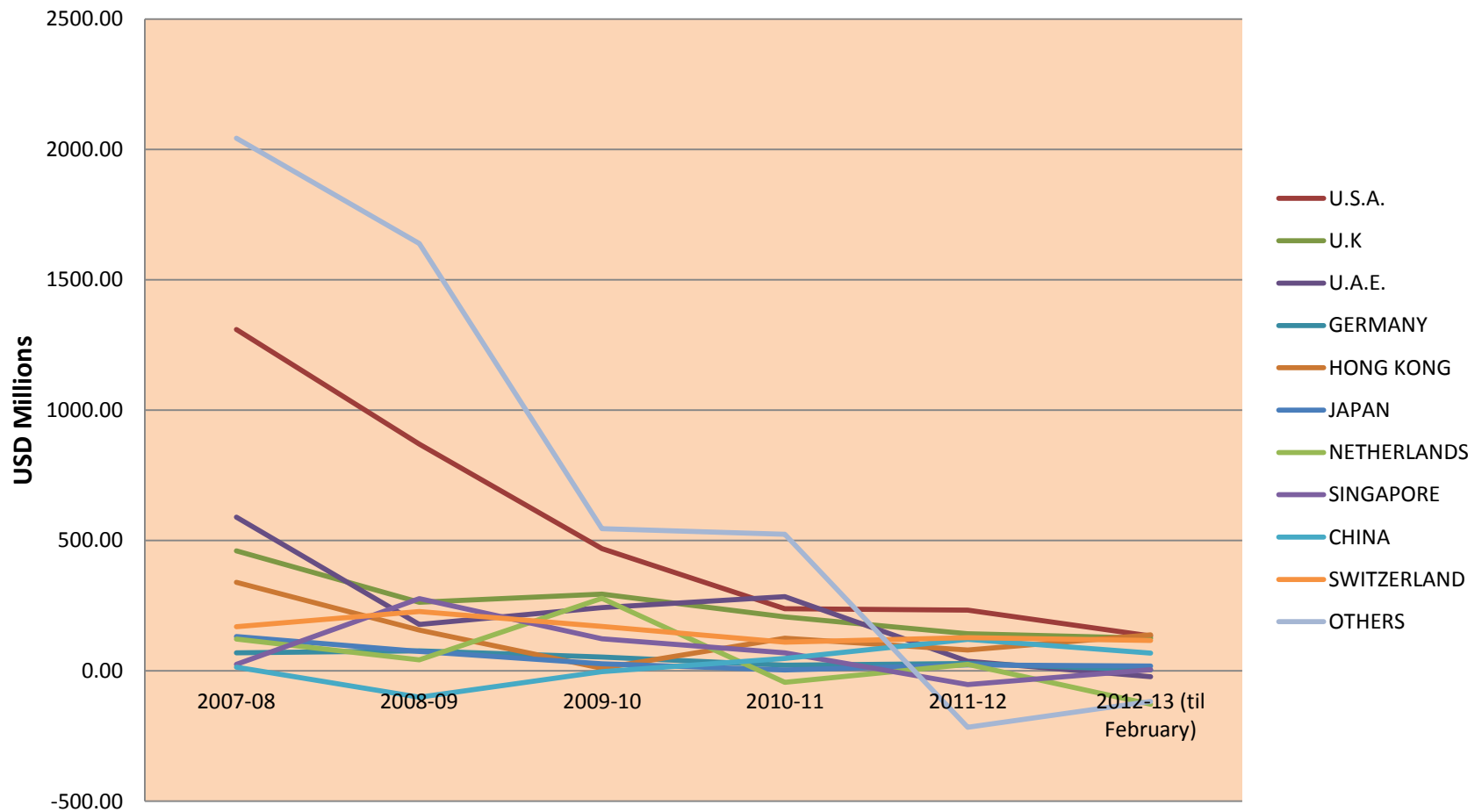
# FDI in Oil & Gas Exploration (MAT)



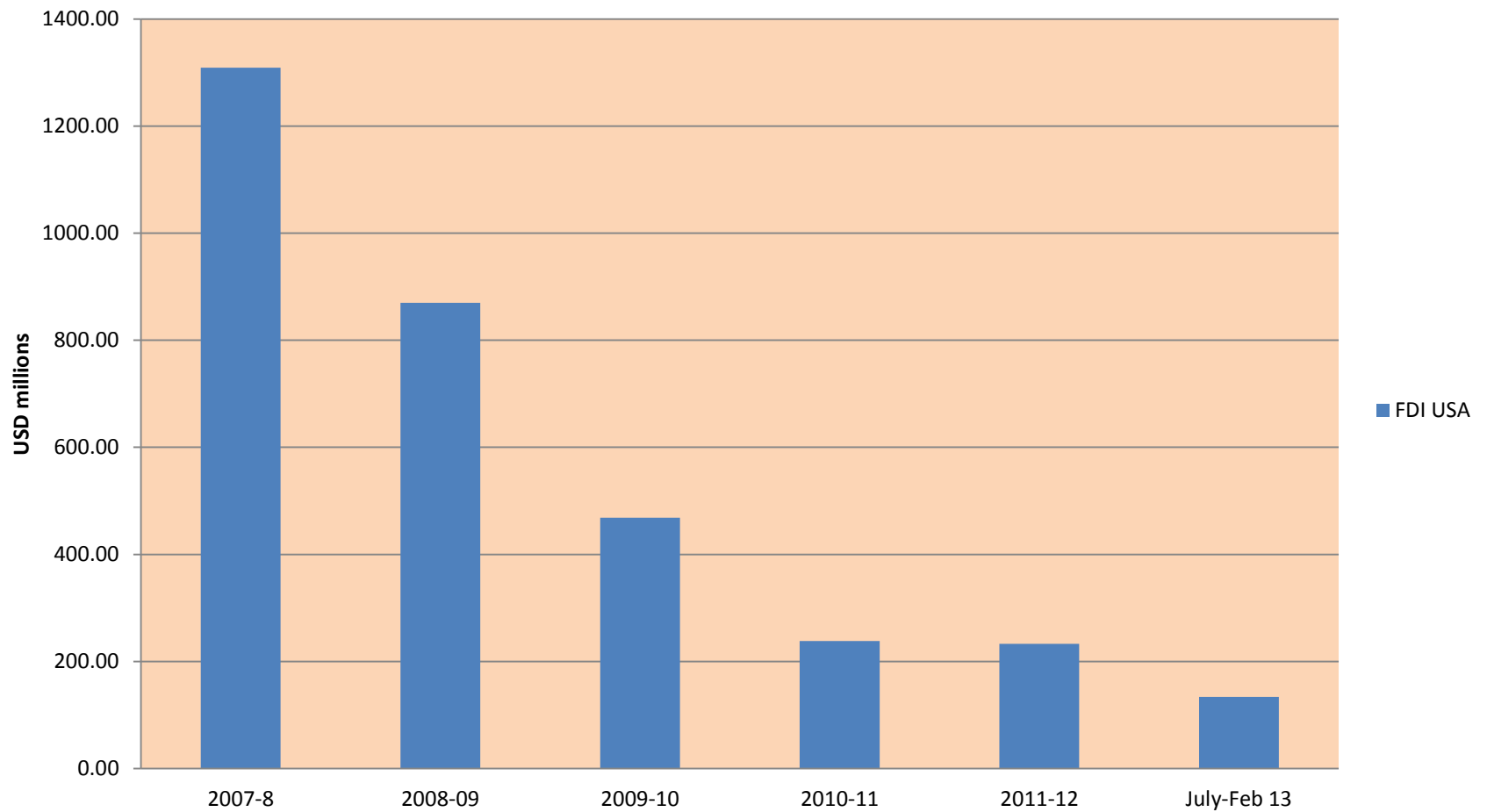
# Total FDI with Total Machinery Imports



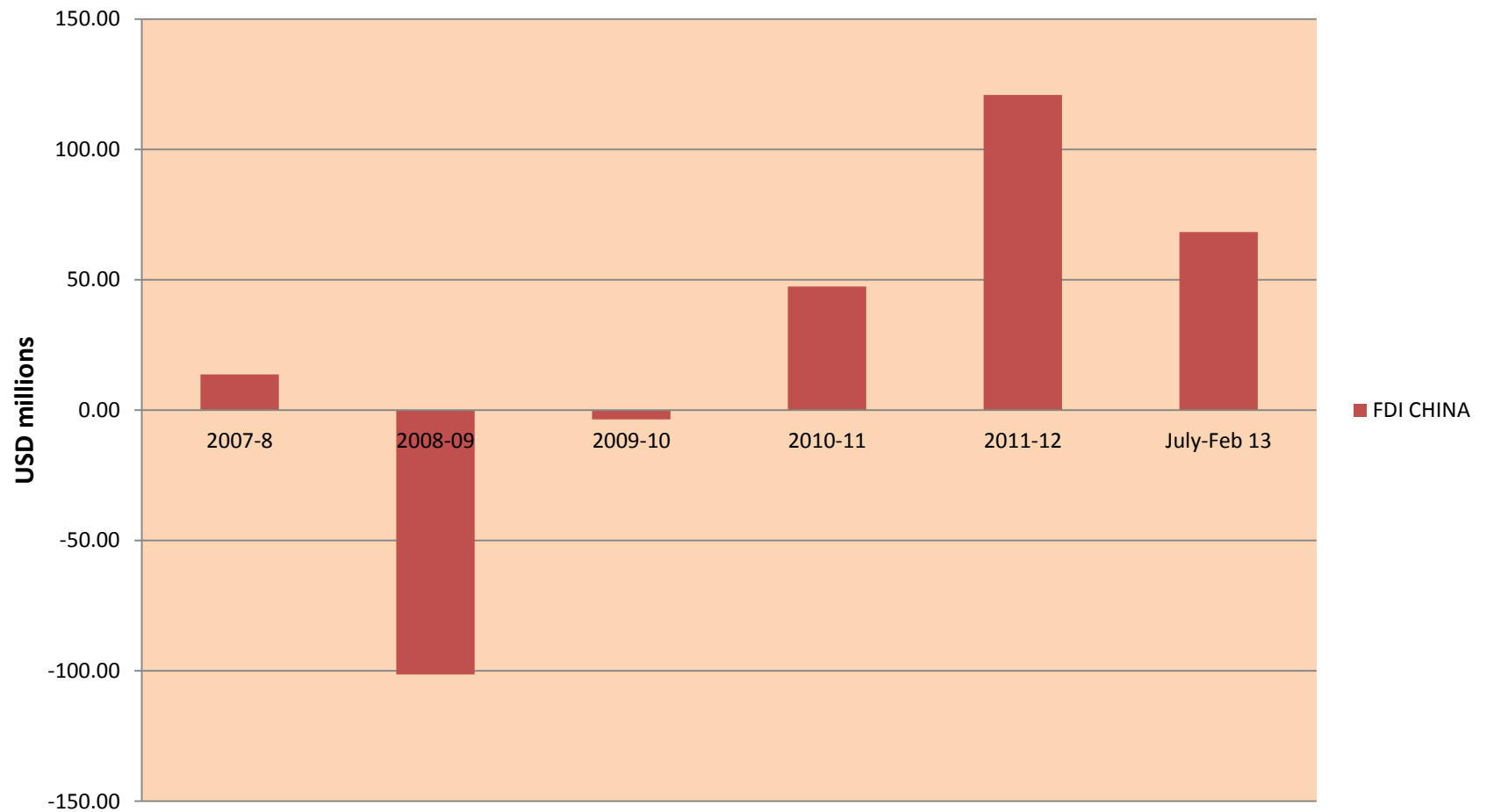
# FDI Major Investing Countries



# FDI From USA

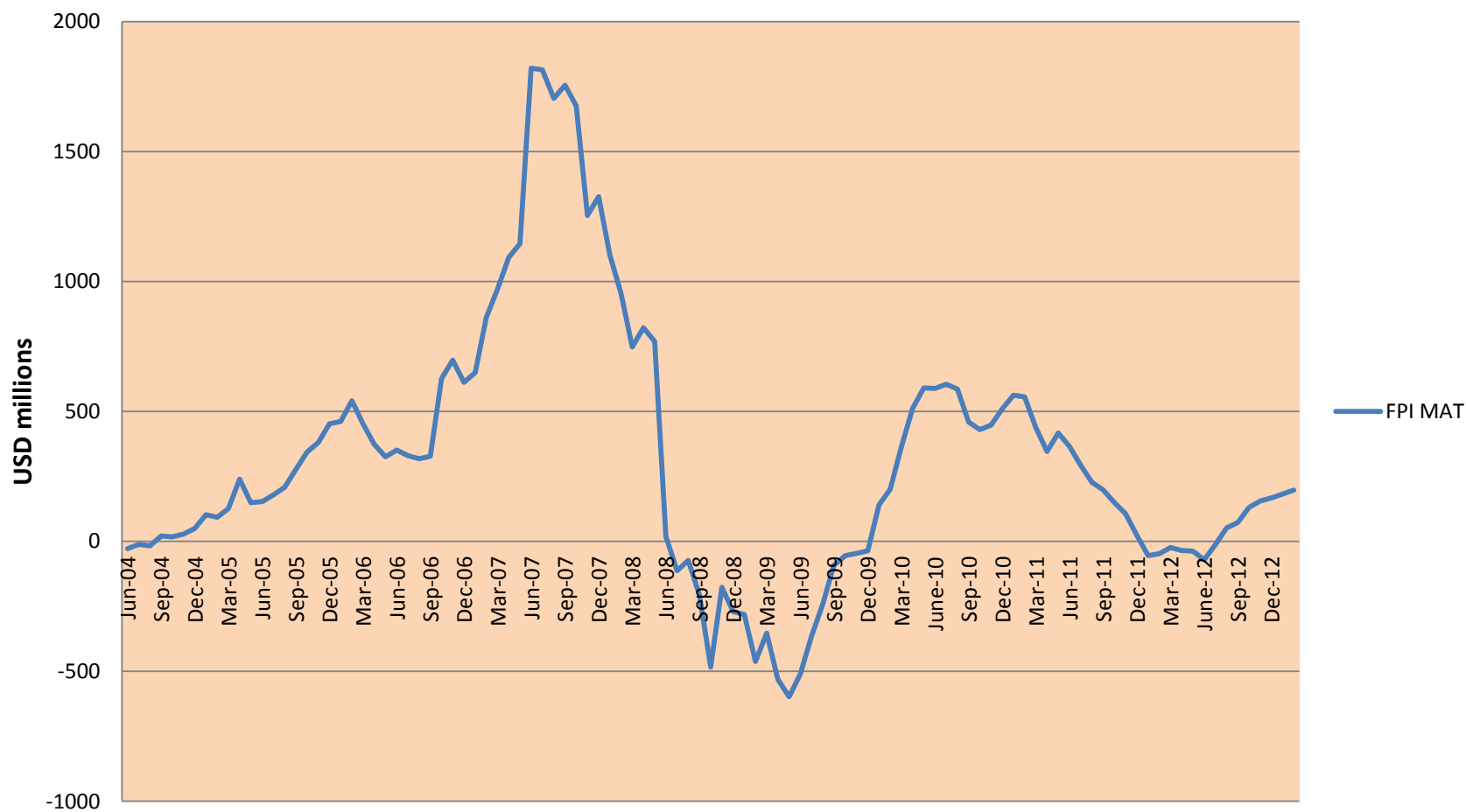


# FDI from China





# FPI Jun-04 to Feb-13 (MAT)

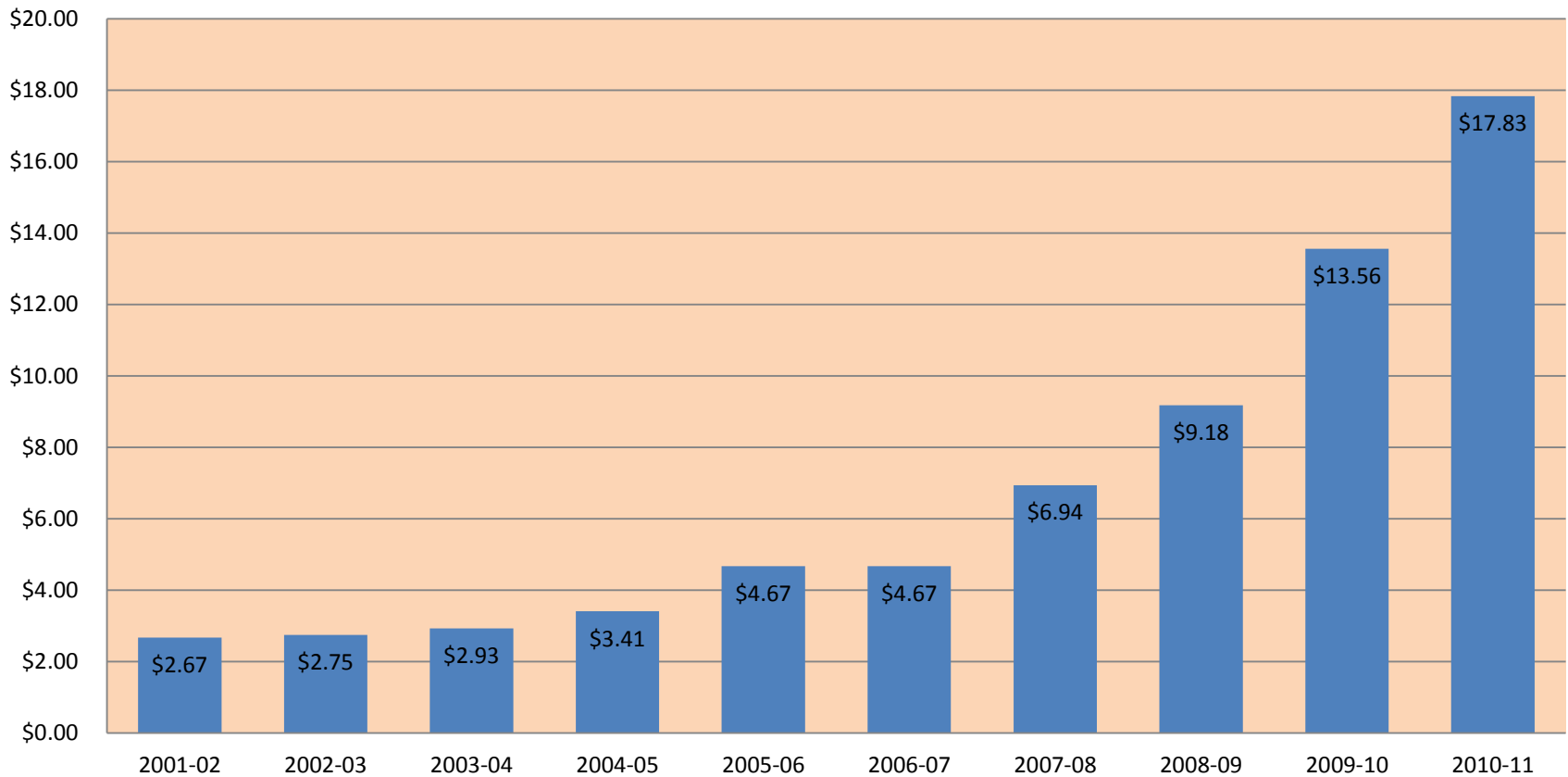


# Pakistan's Losses due to War on Terror

- Pakistan has lost over 35,000 lives and losses worth over \$100 billion during the war on terror
- An indirect cost of War on Terror is dwindling investment (both domestic as well as FDI) in the country
- The investment to GDP ratio has fallen from 22% to 12.5% which is lowest in our history
- During last 12 months the net FDI has also fallen to \$1 billion from the \$5billion mark in 2007
- Pakistan's lost \$3 billion worth of exports only in the current financial year

# Pakistan's Losses due to War on Terror

Amount is in Billion Dollars



# Pakistan's Losses and aid received

- Pakistan has so far received around \$ 15 billion through official channels of which over \$ 10 billion is in shape of Coalition Support Fund (CSF).
- Under the head of military assistance in shape of FMF (Foreign Military Fund), Pakistan received \$2.1 billion, grants for the economy to the tune of \$1.5 billion, budgetary support of \$1.2 billion and debt write- off \$1.5 billion.

# USAID Bilateral Assistance

- The assistance is indeed helping us meet important economic challenges
- We particularly appreciate US assistance under PEPA (Kerry Lugar) for energy security, food security, human development and disaster mitigation.
- Under PEPA , US committed to provide \$ 7.5 billion over FY 2010-2014 (US\$ 1.5 billion annually) though the actual releases are \$4.0 billion from Oct 2009 to Sept 2013 of which around 25% is on budget
- In the energy sector, we are grateful for US support, which will enable the addition of 900 MW electricity to the national grid over the next couple of years.

# USAID Bilateral Assistance

- USAID projects tend to thin-out, i.e. a large number of projects with small grants, stretched over extended periods, fail to generate the desired impact or visibility.
- Pakistan advocates 4 to 5 signature projects like recently signed Peshawar Torkhum road that are visible and impact oriented and, therefore, likely to be well received by the people of Pakistan
- We are therefore requesting USAID to endorse the Diamer-Bhasha Dam and support us in this endeavor.
- Pakistan also requests to increase the portion of USAID which is “on Budget”.

# USAID Disbursement

## Disbursements Between 01 October, 2009 and 30 June, 2013

<u>Color indicates: G2G disbursements</u>	<u>Color Indicates: Interagency transfers and transfer to UN</u>	<u>Color Indicates: Completed Projects with no further disbursements</u>	<u>Color Indicates: NAS funding</u>	<u>Program Support</u>		
	<u>Implementing Partner</u>	<u>Total Disbursements October 01, 2009 to June 30, 2013</u>	<u>In Kind</u>	<u>Transfers from USAID to other agencies</u>	<u>On Budget</u>	<u>Off Budget</u>
<b>TOTAL</b>		<b>3,827,331,279</b>	<b>1,573,848,924</b>	<b>229,385,201</b>	<b>964,253,709</b>	<b>1,059,843,446</b>
<u>ENERGY</u>		<b>252,440,316</b>	-	-	151,368,284	101,072,032
<u>ECONOMIC GROWTH AND AGRICULTURE</u>		<b>185,569,177</b>	-	33,492,777	5,247,890	146,828,510
<u>STABILIZATION</u>		<b>754,377,600</b>	273,475,469	4,080,000	240,928,710	235,893,422
<u>EDUCATION</u>		<b>323,653,801</b>	142,869,461	70,425,000	9,588,423	100,770,918
<u>HEALTH</u>		<b>272,373,528</b>	146,900,523	-	3,979,864	121,493,141
<u>HUMANITARIAN/FLOOD ASSISTANCE</u>		<b>137,303,893</b>	34,104,292	1,000,000	-	102,199,600
<u>Cash Transfer</u>		<b>549,000,000</b>	-	-	549,000,000	-
<u>COMPLEX EMERGENCY &amp; FLOOD RELIEF</u>		<b>1,157,338,000</b>	967,260,000	100,940,000	-	89,138,000
<u>CROSS-CUTTING - DEMOCRACY GOVERNANCE</u>		<b>195,274,964</b>	9,239,178	19,447,424	4,140,539	162,447,823



# USAID Disbursement

(October 1, 2009-September 30, 2013)

Disbursements Between 01 October, 2009 and 30 September, 2013

Color indicates: G2G disbursements	Color Indicates: Interagency transfers and transfer to UN	Color Indicates: Completed Projects with no further disbursements	Color Indicates: NAS funding	Program Support		
	Implementing Partner	Total Disbursements	In Kind	Transfers from USAID to other agencies	On Budget	Off Budget
TOTAL		4,048,113,123	1,584,276,485	230,143,648	1,007,477,360	1,226,215,629
ENERGY		284,289,691	-	-	164,895,589	119,394,102
ECONOMIC GROWTH AND AGRICULTURE		213,087,339	-	35,740,858	5,247,890	172,098,591
STABILIZATION		804,715,345	287,811,457	4,080,000	266,958,878	245,865,010
EDUCATION		337,065,218	147,340,122	70,425,000	11,141,812	108,158,284
HEALTH		284,455,010	150,589,550	-	3,979,864	129,885,596
HUMANITARIAN/FLOOD ASSISTANCE		137,891,447	34,104,292	1,000,000	-	102,787,154
Cash Transfer		549,000,000	-	-	549,000,000	-
COMPLEX EMERGENCY & FLOOD RELIEF		1,218,270,000	954,380,000	100,940,000	-	162,950,000
CROSS-CUTTING - DEMOCRACY GOVERNANCE		219,339,073	10,051,063	17,957,790	6,253,327	185,076,892



# USAID Disbursement

(October 1, 2009-December 31, 2014)

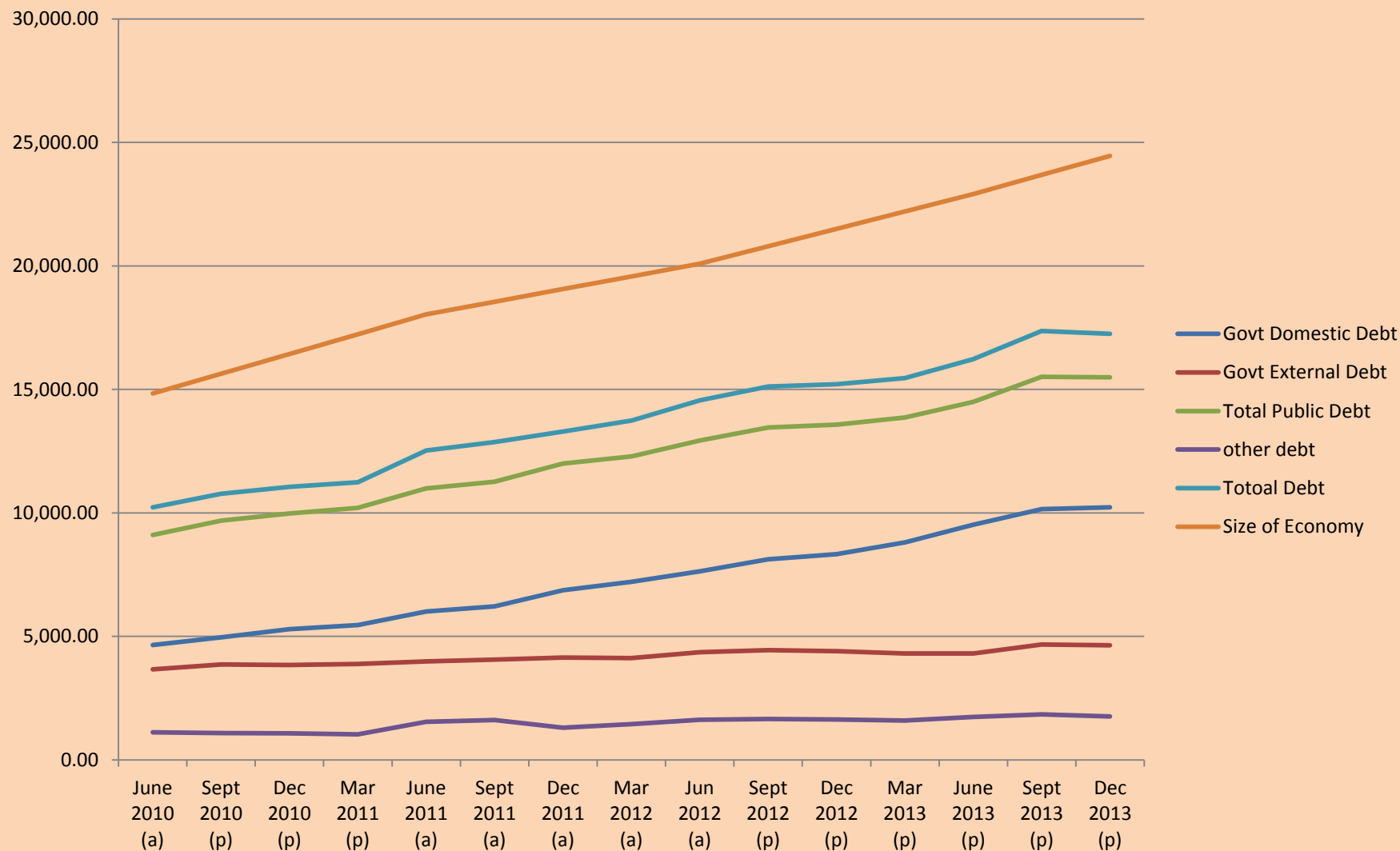
## Disbursements Since 1 October 2009 to 31 December 2013 -(KLB)

by KLB Sector

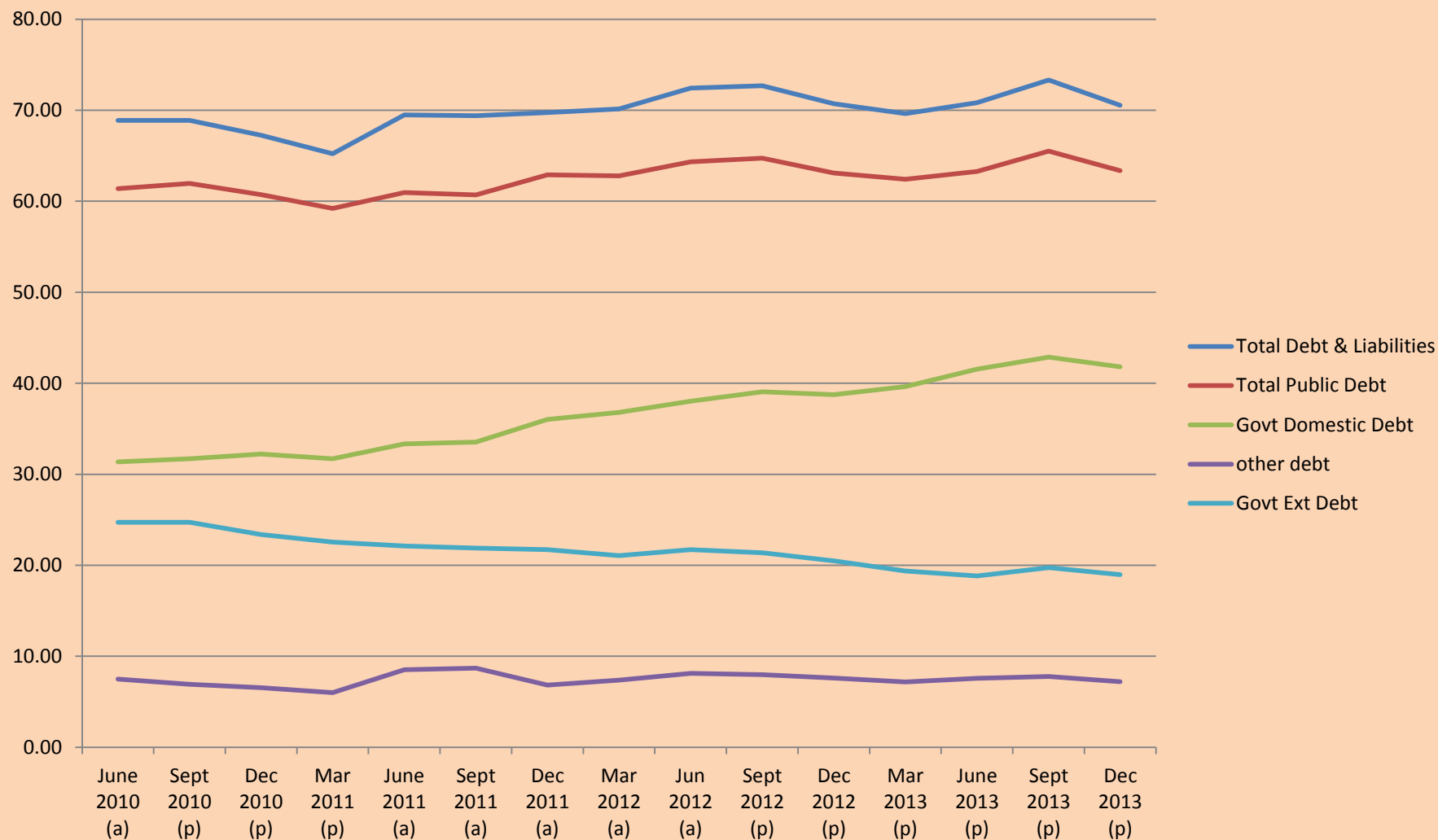
USAID/Pakistan's quarterly "KLB Report." Provides Cumulative (and most recent quarter) disbursement data for all activities disbursing during the KLB period.

			Total Disbursements				
	Award	Partner	Total Disbursements	In Kind	Transfers from USAID to Other Agencies	On Budget	Off Budget
<b>TOTAL</b>			4,134,970,275	1,590,954,123	48,494,249	1,012,188,174	1,483,333,728
Cash Transfer			549,000,000	-	-	549,000,000	-
Cross Cutting/Democracy & Governance			272,054,502	10,051,064	2,475,249	2,322,366	257,205,823
Economic Growth & Agriculture			268,783,726	-	37,999,000	41,247,890	189,536,836
Education			354,424,189	149,685,490	-	8,440,153	196,298,546
Energy			266,648,687	-	-	132,086,764	134,561,923
Health			216,316,037	87,310,177	-	-	129,005,861
Humanitarian/Flood Assistance			151,531,229	63,816,927	-	-	87,714,302
Complex Emergency and Food Relief			1,256,088,200	1,037,478,200	3,940,000	-	214,670,000
Stabilization			800,123,704	242,612,266	4,080,000	279,091,002	274,340,437

# Government Debt in Rupee Value



# Government Debt as Percentage of GDP



# Provincial Tax Base

- Pakistan is a federation created by pre-existing provinces on similar pattern as that of USA, Canada, Australia and India. Provinces in these Federations have considerable tax base.
- Federal transfers are primarily motivated towards equalization for bringing upon greater standardization of quality of services.
- In Pakistan all Provincial and Local Governments put together collect less than 10 to 11% of local national tax revenue.
- There is over-dependence (60% in LDCs, 33% in OECD and more than 80% in Pakistan) on the federal government for resource generation.

# Provincial Tax Base

- Pakistan thus comes out more as a Unitary Form of Country rather than Federation.
- Basic reason for persistent attrition amongst federating units is primarily on account of predominant dependence on federal transfers.
- Pakistan is in fact called “Transfer Dependency” as revenues of provinces can hardly finance 10 to 12% of provinces expenditure.

# Paradigm Shift in Tax Collection

- Trade Liberalization began in the early 1990's and there was a shift import substitution to export promotion.
- Consequently, import tariffs were gradually scaled down from very high initial levels to a maximum tariff of 25% (with exception of few products)
- The average effective rate of duty on imports was 30% in 1990-91, which had fallen below 6% by 2009-10.

# Paradigm Shift in Tax Collection

- Direct taxes went up by 2.1% of GDP from 1.5% to 3.6% during 1990/91-2009/10 period
- The Indirect taxes during this period went down from 8.46% to 5.4% of GDP
- Contribution of Customs duty over this period declined from 4.89% of GDP to 1.1% of GDP
- CED went down from 2.07 to 0.8%
- Sales Tax contribution went up by 2% of GDP from 1.5% to 3.5%
- Overall tax collection as a %age of GDP went down from 11.47% to 10.2%

## Tax-to-GDP Ratio, total and of Individual Taxes 1990-91 to 2009-10 (%)

	Direct Taxes	Customs Duty	Sales Tax	Central Excise Duty	Indirect Taxes	Total FBR Taxes	Surcharges	Total Federal Taxes	Total Provincial Taxes	Total Taxes
<b>1990-91*</b>	<b>1.49</b>	<b>4.89</b>	<b>1.50</b>	<b>2.07</b>	<b>8.46</b>	<b>9.95</b>	<b>1.01</b>	<b>10.96</b>	<b>0.51</b>	<b>11.47</b>
<b>1994-95*</b>	<b>2.74</b>	<b>3.45</b>	<b>1.94</b>	<b>1.94</b>	<b>7.33</b>	<b>10.07</b>	<b>0.92</b>	<b>10.99</b>	<b>0.50</b>	<b>11.49</b>
<b>1999-2000</b>	<b>2.95</b>	<b>1.61</b>	<b>3.05</b>	<b>1.46</b>	<b>6.12</b>	<b>9.07</b>	<b>1.02</b>	<b>10.09</b>	<b>0.47</b>	<b>10.56</b>
<b>2004-05</b>	<b>2.82</b>	<b>1.78</b>	<b>3.67</b>	<b>0.82</b>	<b>6.26</b>	<b>9.08</b>	<b>0.41</b>	<b>9.49</b>	<b>0.45</b>	<b>9.94</b>
<b>2006-07</b>	<b>3.85</b>	<b>1.52</b>	<b>3.57</b>	<b>0.82</b>	<b>5.91</b>	<b>9.76</b>	<b>0.74</b>	<b>10.5</b>	<b>0.42</b>	<b>10.92</b>
<b>2007-08</b>	<b>3.77</b>	<b>1.47</b>	<b>3.76</b>	<b>0.82</b>	<b>6.05</b>	<b>9.82</b>	<b>0.34</b>	<b>10.16</b>	<b>0.40</b>	<b>10.56</b>
<b>2008-09</b>	<b>3.47</b>	<b>1.16</b>	<b>3.55</b>	<b>0.91</b>	<b>5.62</b>	<b>9.09</b>	<b>0.99</b>	<b>10.08</b>	<b>0.36</b>	<b>10.44</b>
<b>2009-10</b>	<b>3.60</b>	<b>1.10</b>	<b>3.50</b>	<b>0.80</b>	<b>5.40</b>	<b>9.00</b>	<b>0.80</b>	<b>9.80</b>	<b>0.40</b>	<b>10.20</b>

\*GDP increased by 20.6% following the rebasing of national income accounts



# Challenges in Tax Reforms

- Agricultural Income Tax was levied with the target of 40 billion but achieved only 6% or so of it. Reason no political will
- General Sales Tax on retailers with turnover of over 5 million. Failed due to agitation
- Sales Tax on services like Doctors, Private Schools and Lawyers etc again no political will
- Value Added Sales Tax biggest failure again owing to lack of political will

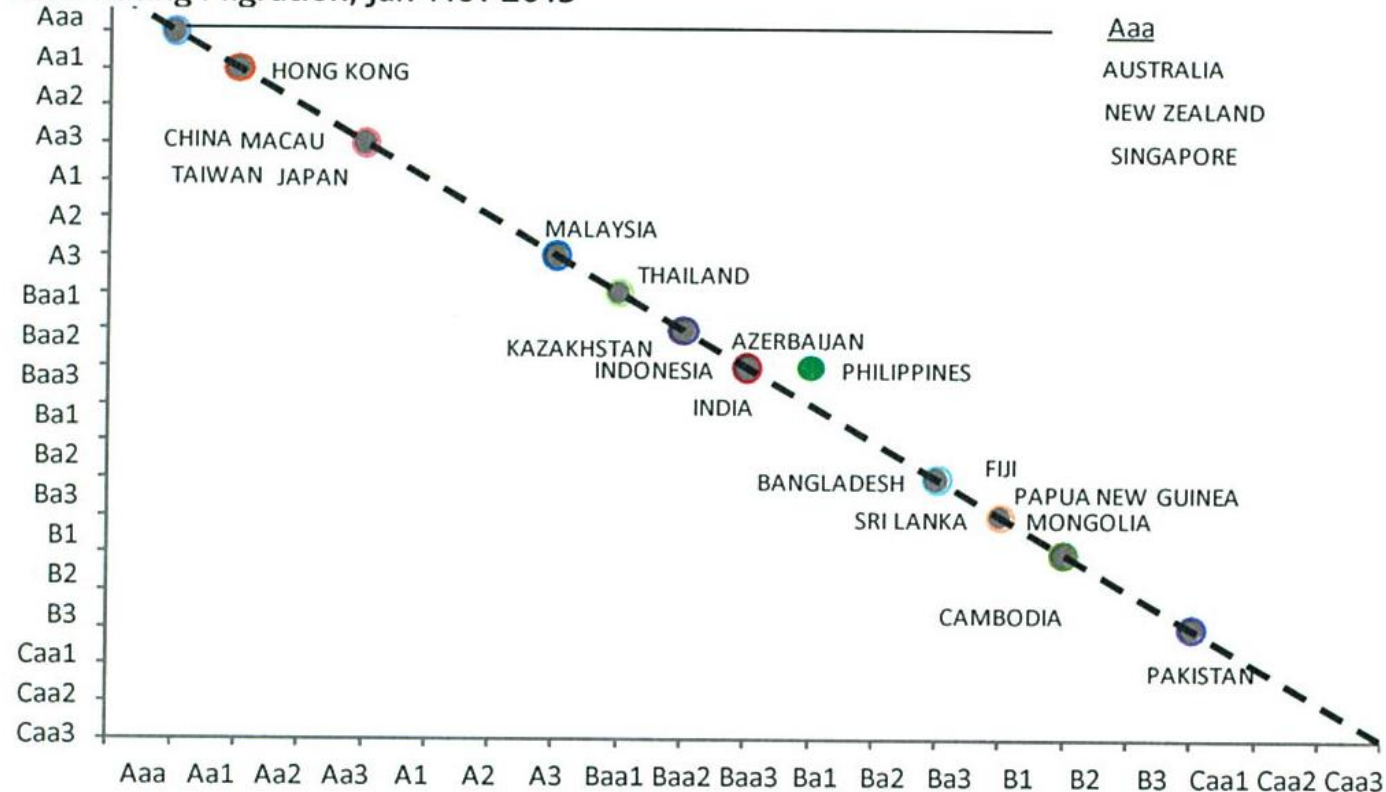
# Provincial tax-to-GDP Ratio

- Currently 4 provinces combined are generating less than 0.5% of GDP as own revenues.
- There is a real danger of further slackening of the provincial fiscal effort following the 7th NFC Award, which has increased the share of provincial transfers to 57 % of the total divisible pool.
- Provinces ought to fully exploit their revenue potential and to not substitute own revenue by federal transfers.
- Provinces have 3 promising revenue sources under their fiscal jurisdiction---Sales Tax on Services, Agricultural income tax (AIT) and urban immoveable property tax.

# Asia: Rating Migration, Jan – Nov 2013

EXHIBIT 2

## Asia: Rating Migration, Jan-Nov 2013



Source: Moody's Investors Service

# Recommendations and Remedial Measures

- Pakistan needs wide-ranging fiscal reforms that can restore the economy back towards the requirements of the Fiscal Responsibility and Debt Limitation Act (2005).
- In particular, there is an urgent need to address the issue of the falling tax to GDP ratio which has been in single digit for a long time.
- Revenue-enhancing measures need to be complemented with effective expenditure control measures, especially the removal of untargeted and distortionary subsidies while increasing coverage of social safety nets.

# Recommendations and Remedial Measures

- The private productive activity and investment will have to increase considerably and quickly, especially when the DR have come down and banks have sufficient liquidity and lending capacity
- A sustainable pro-poor and balanced growth path, people centric development policies that provide jobs, education, skills, housing, health and income support, as a comprehensive package for the poor
- Public-private partnership should be the key strategic element of the development strategy which will be production – led rather than consumption-driven

# Recommendations and Remedial Measures

- Last but not the least the government should enforce agricultural income tax which will not only increase provincial revenues but also curb misreporting.
- Government should make integrated efforts to achieve the GDP growth of 5.5% growth for at least 5 years
- With an Incremental Capital Output Ratio of about 4 Pakistan Economy needs an investment to GDP ratio plus of 20% most of which should go to energy sector
- The change in resource distribution formula has resulted in decline in federal Public Sector Development Program and increase in provincial Annual Development Programs. The new arrangement calls for more efficient planning to increase the multiplier which is currently 2