**Pakistan amidst a polycrisis**

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* [whatsapp](https://api.whatsapp.com/send?text=Pakistan%20amidst%20a%20polycrisis%20https://e.thenews.com.pk/detail?id=234925)

The caretaker government has made a sensible decision to link any possible relief in electricity bills to the consent of the IMF in order not to jeopardize the ongoing standby agreement.

Pakistan needs to stay under the IMF umbrella for at least the next few years, not only to overcome its chronic balance-of-payments challenges (dollar shortage) and take much-needed policy and structural reforms under IMF scrutiny but also to regain the trust of local and international investors. This trust is crucial to ensure both a steady flow of dollars and prevent their hoarding or outflow. Without overcoming the trust deficit, the value of the rupee will remain under pressure.

As I write this piece, the dollar is trading at Rs305.50 in the interbank market, Rs330 in the open market, and Rs345-355 in the hawala market. Despite appreciating by Rs17 against the rupee in the last 13 days, the interbank rate of the dollar is still far behind the open market rate, breaching the difference threshold that Pakistan committed with the IMF.

On the other hand, high demand for imports, negative market sentiments, hoarding, smuggling of greenbacks to Afghanistan, and uncertainty on election dates are pushing up the price of dollar against rupee in the open market. In fact, the difference between the hawala and interbank rates, as well as open market and interbank rates, has once again widened. This makes it unappealing for remitters to send their remittances through official banking channels.

Wonder why I am discussing the exchange rate in a piece on energy prices? Please keep in mind that the depreciation of the rupee has serious repercussions for the electricity sector. Assuming that all other factors, including the international oil, coal and gas prices, remain unchanged, the current rupee weakening would result in higher electricity bills after two months.

This is due to two reasons: a higher fuel import bill (reflected as fuel price adjustment every two months), and higher capacity payment charges (which are denominated in dollars) that the government is bound to pay to electricity generation companies even if it does not buy a single unit of electricity from them.

Politically motivated delays in recovering the cost of generation of electricity during the last 16 years resulted in accumulation of energy circular debt (ECD), which, along with transmission and distribution losses and cross-subsidies on tariff, piled up to Rs2.6 trillion by June 2023. For comparison, the ECD is one and a half times higher than Pakistan’s current year’s defense budget. An attempt to contain ECD in FY24 at the Rs2.6 trillion level means full recovery of all costs from consumers during the current financial year. The result was exceptionally high electricity bills in August, which will further inflate as the rupee depreciates further.

We should also remember that it is not only the fuel and transmission-distribution costs that are pinching the consumers. A major chunk of our electricity bills also consists of taxes and surcharges on those taxes, which every consumer, regardless of his/her income (and in some cases electricity consumption level), has to pay to meet the government’s growing revenue requirement.

Before discussing why the government uses electricity bills for the generation of revenue, let us continue with the impact of the depreciated rupee.

The depreciated rupee also increases the domestic prices of petrol and diesel. The current rise in fuel prices will result in another round of inflation and likely another round of public discontent.

The textbook way of curbing inflation is to increase the interest rate. However, high interest rates not only adversely affect businesses and export competitiveness but also increase the government's domestic debt servicing cost, requiring additional revenue. Due to chronic failure to generate revenue through direct taxation, the government ends up relying on indirect taxation. Electricity bills are one such tool for collecting indirect taxes and that is why successive governments are tempted to keep adding taxes to them.

Amidst this vicious cycle where one economic problem leads to another, the pressure on caretakers will mount to provide relief, especially on energy costs. However, in the current fiscal framework, they have no cushion to provide such relief. To address the growing discomfort among consumers, the caretaker government should try to redesign the fiscal framework. It needs to enhance revenue mobilization and reduce its expenditure. Additional revenue can be mobilized by bringing the ‘taxable untouchables’, both elite individuals and pampered sectors of the economy, into the tax net. Everyone knows who they are and why – due to different political-economy considerations, successive governments failed to tax them.

On expenditure reduction: besides many symbolic austerity measures, one of the ways to reduce expenditures is to privatize the loss-making public-sector enterprises (including electricity distribution companies). The caretaker government must kickstart the process of privatization of such units. However, the time is too short for them to successfully complete any privatization deal. The quickest way to reduce expenditures is to slash ‘politically motivated’ brick-and-mortar projects from federal and provincial development plans. If the amount spent on proposed relief in the energy sector is offset by a reduction in PSDP, then the IMF may not object.

A cushion for such relief can also be created by reducing the unit cost of electricity by reducing the chronic inefficiencies, power theft, and misuse of entitlements in the power system.

To contain the depreciation of the rupee, the government would have to improve the inflow of dollars. The two major sources of dollar inflow, exports and remittances, are declining and must be improved. However, in the short run, caretakers should focus on securing some of the $9 billion Geneva pledges for the 2022 floods. Those pledges could not be materialized during the last fiscal year as the IMF’s support for Pakistan remained suspended in that period.

Now that Pakistan is back in the Fund’s programme, access to those pledges depends on the preparation of tangible and concrete projects for flood rehabilitation and disaster preparedness. The best way to do it is through a cabinet committee and inter-ministerial coordination mechanism to prepare some convincing projects for the Asian Development Bank, World Bank, and Islamic Development Bank.

I can foresee some high-level visitors coming to Pakistan in mid-September before or after the G-20 meeting in Delhi. Such visits would help boost the market’s sentiments. However, a strong follow-up is required to capitalize upon the bilateral consensus achieved during such visits. Clarity on the expected length of the present caretaker setup and the general elections’ timeline is a prerequisite for such follow-up.

In the meantime, the caretakers should act swiftly and decisively to break the vicious cycle of economic and energy crises and pave the way for sustainable recovery.

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