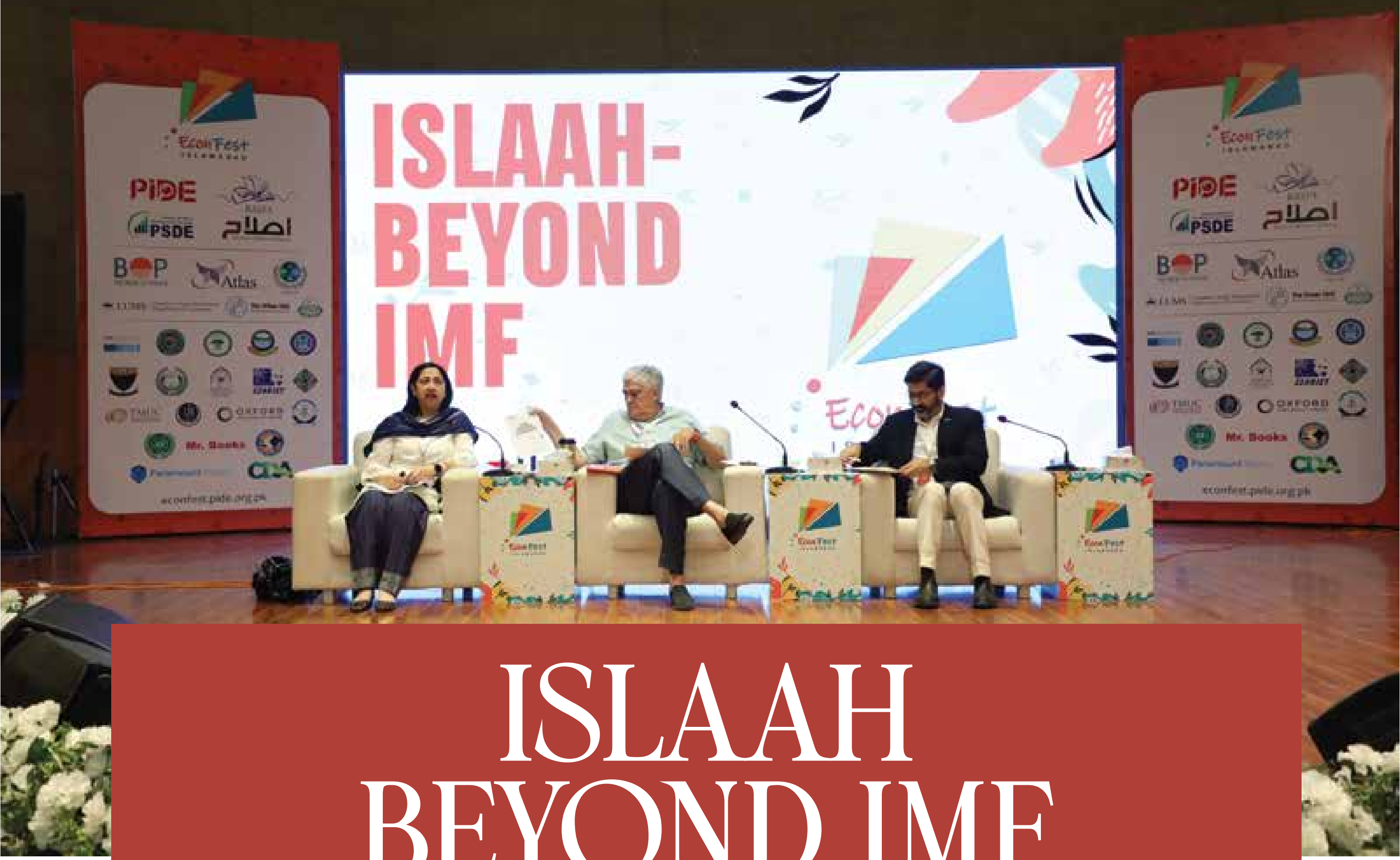

ISLAAH BEYOND IMF

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CONTEXT:

Pakistan's economic stability has long been precarious, which is why the country's economic history over the past decades has been marked by frequent recourse to IMF assistance. Entering its 24th IMF program accentuates the severity of its financial struggles. Over the next five years, Pakistan's external financial requirements will exceed USD 120 billion, creating a significant gap that even the most optimistic IMF projections may struggle to bridge.

This recurring reliance on IMF assistance highlights the persistent structural issues and cyclical financial crises that have plagued Pakistan for decades. The frequency with which Pakistan turns to the IMF is not just a symptom of immediate fiscal shortfalls but a reflection of deeper, systemic inefficiencies and governance challenges that must be addressed to achieve long-term economic resilience. Despite numerous interventions, the underlying problems continue to resurface. The IMF's repeated recommendation to raise taxes has proven ineffective in the past and is unlikely to succeed in the future. This indicates that Pakistan requires more profound and sound economic reforms based on local research and tailored solutions.

The reliance on IMF programs indicates a broader issue of fiscal irresponsibility and lack of structural reforms. Despite these programs, Pakistan's growth has remained lackluster and sporadic, failing to meet the needs of its young and rapidly growing population. The output gap and the underlying economic weaknesses that need to be addressed through more than just financial injection.

Pakistan Institute of Development Economics (PIDE) outlines a comprehensive reform agenda to address these deep-rooted problems[1]. PIDE believes that at this time IMF program is a necessity. It also believes that restructuring debt will be difficult and time-consuming. But, PIDE stresses the necessity for reforms that go beyond the superficial adjustments typically mandated by IMF programs. It calls for a systemic overhaul that addresses the root causes of economic instability, including governance issues, policy inconsistencies, and structural inefficiencies.

Pakistan's rapidly growing population, with nearly 4 million new entrants to the working-age population each year, necessitates the creation of almost 2 million job opportunities annually. This rate of labor force participation requires ample employment opportunities. Additionally, Pakistan's mounting debt burden needs to be addressed. To reduce the debt burden and create sufficient job opportunities, Pakistan must sustain a growth rate of at least 7 to 8 percent. PIDE estimates that achieving this target requires an investment equivalent to 28.8 percent of GDP (based on ICOR), nearly double the current level. Meeting this investment demand calls for significant enhancements in domestic savings rates and foreign direct investment (FDI) inflows. Prioritizing investment necessitates substantial deregulation, efficient and functional markets, and digital governance.

Pakistan's journey towards economic stability and growth requires a comprehensive and sustained reform agenda that goes beyond short-term fixes typically suggested by IMF and foreign consultants. PIDE's proposed interventions aim for more ambitious targets than those set by the IMF. We aspire to achieve official reserves covering 4 to 5 months of imports within three years and eliminate the financing gap in the same period. We aim to reduce inflation to 10 percent within 18 months and cut the fiscal deficit by 4 percentage points by the end of three years. Additionally, we plan for a steady decrease in the primary balance, reaching 1 percent. These targets reflect a commitment to robust economic stability and growth, surpassing conventional benchmarks.

Here we present the details of PIDE's proposed interventions:

MODERNIZING REGULATORY FRAMEWORK:

Clear rules with digitization, not permissions, are needed. Permissions cost us time and resources, while documentation costs are huge. Therefore, we must end bureaucratic control and the need for permissions, certificates, and similar requirements. Pakistan should move away from the colonial bureaucratic style of governance, as this outdated model hinders growth and the development of a strong economy. So, a fundamental aspect of the proposed reforms is the modernization of the regulatory framework. This involves creating independent regulatory bodies free from political interference, and ensuring that regulatory decisions are made based on merit and economic rationale.

[1]https://pide.org.pk/research/immediate-reform-agenda-imf-beyond/

An urgent cabinet decision is required to eliminate all registrations, licenses, certificates, and other permissions (RLCOs) within three months, except for those related to prohibited activities. In the meantime, new RLCOs should be prepared with a clear cost-benefit analysis and presented to the cabinet. After three months, only newly approved permissions, if any, will be valid. Moving forward, Pakistan needs an Office of Management and Budget similar to that in the USA and should introduce a Paperwork Reduction Act, akin to the one introduced in the USA in 1980.

Regulatory Impact Analysis (RIA) must be mandatory for all future regulations. Cabinet and Parliament should require RIAs before approving any regulation. Additionally, current regulations must undergo regular RIA assessments to ensure their continued effectiveness and relevance. No new rules should be proposed without a proper cost-benefit analysis presented to the public, parliament, and cabinet. The Planning Commission should lead regulatory modernization efforts by conducting regular RIAs across all sectors, ensuring that all new regulatory proposals are reviewed by the Central Development Working Party (CDWP) with an accompanying RIA before reaching the Cabinet.

FISCAL CONSOLIDATION:

We have pursued increased taxes through all IMF programs and consistently failed due to a cumbersome, distortionary, and volatile tax system that creates significant uncertainty in the economy. Government expenditures and balance sheets are often overlooked, to our extreme detriment. It is urgently necessary to simplify taxes in this budget in a revenue-neutral manner and maintain stability for the next ten years without introducing new taxes annually. There should be a uniform tax rate across all sources of income, including agriculture income. The presumptive tax regime should be ended and taxes on turnover, such as Alternative Corporate Tax, should be eliminated. Uniform taxes should be applied to AOPs, sole proprietors, and corporations. Inter-corporate dividend income and assets sold within a year should be treated as normal income. Withholding taxes should be eliminated in favor of advance income tax. Concessionary financing and discriminatory fiscal incentives between businesses should cease. Tax administration should be automated and streamlined to minimize human interaction. Abolish the distinction between filers and non-filers, and the use of FBR rates for property valuations. A responsible and accountable tech-savvy group should be allowed to collect revenue, with an independent service knowledgeable in technology and modern auditing techniques overseeing the process. Audits of tax returns for first-time filers should be halted for the next five years.

Effective fiscal consolidation is more than just increasing tax revenues. It requires a holistic approach that includes rationalizing public expenditures, use of assets, reducing waste, and improving the efficiency of public sector investments. The goal is to create a sustainable fiscal environment that supports long-term growth.

THE STATE CAPTURED ASSETS AND LAND:

The state-controlled real estate sector represents a significant but underutilized asset. Government assets, such as roads, convention centers, stadiums, and auditoriums, have been built but are not being utilized for high returns. While the IMF focuses on income statements, immense value lies in the effective utilization of these assets. Efficient utilization of these assets could unlock substantial economic value

The utilization of state-captured real estate presents a significant opportunity for economic growth and development. The potential value of real estate is staggering, amounting to PKR 2,278.6 billion with 17,471 government houses occupying 1,325 acres of prime land in Islamabad only. If monetization on market rate is made for house rents it would be ranging from 135.9 billion to 741 billion rupees, depending on rental values varying from lowest to highest. Moreover, reimagining the zoning regulations to accommodate high-rise mixed-use developments, incorporating public and green spaces, could unlock even greater potential. This strategic approach could attract over USD 58.8 billion in investment, create 351,000 job opportunities, add 44.4 million sq. ft of commercial space, and generate an annual rental income surpassing Rs. 446.8 billion. Such endeavors have the potential to generate tax revenue ranging from PKR 160 to 300 billion. Such initiatives not only optimize the use of valuable land but also stimulate economic activity, fostering a vibrant and sustainable urban environment for the future. Furthermore, by adopting a public-private partnership model, the revenue generated could be significantly amplified. However, executing this vision requires meticulous planning and thoughtful consideration to ensure its success and sustainability in the long run.

Expanding upon the initiative to assess and utilize state-captured land, a comprehensive examination of all underutilized state-owned assets is imperative. Relying on taxation to finance such assets warrants scrutiny. Establishing a high-level professional commission tasked with developing an asset register and devising mechanisms for optimal asset utilization is essential. Leveraging public-private partnerships can significantly enhance the effectiveness of this endeavor, allowing for innovative approaches and maximizing resource utilization. This concerted effort ensures prudent management of state assets while fostering economic growth and efficiency in resource allocation.

ACHIEVING SUSTAINED GROWTH THROUGH MARKET REFORMS:

For effective, efficient, and functional markets, PIDE prioritizes and suggests reforms in the energy, real estate, banking, and financial markets, along with the liberalization of agricultural markets.

Energy Market Reforms: Circular debt, inefficiency, and mismanagement have plagued the sector for years. Proposed reforms include the commercialization and corporatization of energy companies, improved governance through independent boards, and the introduction of competition in the energy market.

Governance Reforms	Commercialization and Corporatization	Policy Revisions
Establishing independent, empowered commissions to oversee the energy sector is essential. These commissions should comprise technocrats and operate under the supervision of parliamentary committees to ensure accountability and transparency	Mandatory disclosure of all energy companies on the stock market with limits on shareholding is recommended to ensure broad-based ownership and prevent monopolistic practices. Management contracts should be considered to bring in expertise and improve operational efficiency	Rationalizing the number of power entities and revisiting the uniform tariff policy are necessary steps to improve the efficiency of the power sector. Tariffs should reflect the actual cost of services, and subsidies should be provided through direct cash transfers rather than through cross-subsidization

REAL ESTATE MARKET:

The real estate sector requires significant reforms to become more dynamic and market-oriented. Key measures include creating a transparent property market, improving land administration systems, and ensuring efficient and fair real estate transactions. It's crucial to move beyond the narrow focus on "Plotistan" or Housing Societies and recognize real estate as encompassing major construction projects that develop city centers and commercial areas. This shift is vital for urban development, necessitating the deregulation of downtown areas to facilitate large-scale investments and revitalize urban cores. Implementing flexible building regulations, especially regarding building heights within city limits, is essential to curb urban sprawl and promote sustainable development, aligning real estate strategies with the evolving needs of modern cities.

Currently, the real estate market is fragmented and plagued by insider trading (qabza) and artificially administered prices set by DC rates and FBR valuations. Multiple land rates for taxation purposes create barriers to market development, while regulatory incentives have fostered information hiding, exacerbating market opacity. Real estate agents wield significant influence, and file trading has become prevalent due to regulatory negligence. Zoning rules contribute to urban sprawl and market segmentation, highlighting the need for a reevaluation of urban planning strategies. Addressing these challenges could unlock significant revenue gains, estimated at up to PKR 300 billion, and foster a more transparent, efficient, and sustainable real estate market.

To revolutionize the sector, several decisive measures are essential. Abolishing FBR valuation and DC rates will eliminate artificial pricing barriers, enhancing market transparency. Regulating file trading under the Securities and Exchange Commission of Pakistan (SECP) as securities will curb speculative practices. Separating regulation from the real estate business will mitigate conflicts of interest and enhance oversight effectiveness. Organizing the real estate brokerage industry ensures ethical standards and consumer protection while updat ing rental laws will foster a fair and stable rental market. Relaxing zoning regulations for vertical and mixed-use development across all cities promotes urban density and efficient land use, fostering transparency, efficiency, and sustainable growth in the real estate sector.

BANKING AND FINANCIAL SECTOR:

To support economic growth, the banking sector must address high non-performing loans, regulatory hurdles, and the crowding out of private credit by government borrowing. Developing non-bank financial entities and easing entry into banking will enhance competition, innovation, and financial inclusivity. Encouraging local, regional, and thrift institutions promotes local economic development. A robust foreign exchange market ensures currency stability and facilitates trade and investment. Expanding the network of primary dealers boosts market liquidity and efficiency. Together, these measures create a dynamic, resilient financial ecosystem, empowering individuals and businesses and fostering economic growth and stability.

LIBERALIZING AGRICULTURE MARKETS:

Agriculture is a vital part of Pakistan's economy, yet it suffers from inefficiencies and a lack of modernization. To enhance productivity and ensure food security, liberalizing the agricultural market, removing market-distorting subsidies, and encouraging private sector investment are essential. Key reforms include discontinuing support prices and abolishing commodity operations to let market dynamics dictate pricing, fostering competition and innovation. Eliminating seed registration and testing in favor of market-driven brand reliability will streamline the agricultural inputs market. Ensuring rules for truth in labeling and setting up seed companies promotes transparency and accountability. Clear penalties for malfeasance will safeguard market integrity. Encouraging private storage through five-year tax incentives for certified facilities will improve storage infrastructure, while the government should exit the storage business to allow private enterprises to thrive. These measures collectively aim to create a robust, transparent, and efficient agricultural market.

WAY FORWARD: A THOUGHTFUL MARKET ECONOMY:

PIDE emphasizes for a transition into a serious market economy, it must adopt policies that promote competition, innovation, and private sector growth. This includes:

Developing a Shareholder Economy: Encouraging broader ownership of businesses and involving institutional investors can create a more resilient and inclusive economy. This approach aligns the interests of shareholders with long-term economic growth and stability.

Enhancing Branding and Innovation: Promoting innovation and value addition through branding can significantly boost Pakistan's competitiveness in the global market. This requires investment in research and development, fostering an entrepreneurial culture, and supporting startups.

Liberalizing Markets: Liberalizing various markets, including the energy, real estate, and agriculture sectors, is crucial for enhancing efficiency and productivity. This involves removing unnecessary regulatory barriers, promoting competition, and ensuring that market transactions are transparent and fair.

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