

# Pakistan's Vulnerable Groups and IMF Conditionalities Amid 24<sup>th</sup> Program

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## 1. Introduction

Pakistan is on the eve of its 24<sup>th</sup> International Monetary Fund (IMF) program amid structural problems such as low growth prospects, persistent macroeconomic imbalances, and skyrocketing prices of essential items and utilities. In the final review of the 23<sup>rd</sup> Stand-By Arrangement (SBA), the IMF's Executive Board reiterated on policy measures such as fiscal adjustment and debt sustainability, buffering external shocks through a market-determined exchange rate, proactive monetary policy, along with structural reforms like energy sector viability, governance of State Owned Enterprises (SOEs). Accordingly, the government presented the IMF-guided budget on June 12, 2024 for financial year 2024-25.<sup>1</sup> The main objective of the budget is to keep the primary balance in surplus, which forces the government to create avenues for additional revenue. The reasons are obvious as Pakistan is faced with persistent fiscal deficit due to higher debt-servicing, growing circular debt of the power sector, and losses of the SOEs. Similar is the case with current account deficit amidst poor exports performance and dwindling reserves. To cope with circular debt, the IMF has directed the government to raise the tariff rates of electricity along with raising Petroleum Development Levy (PDL).<sup>2</sup> This, along with the increase in General Sales Tax (GST) on certain items, have significant implications for prices of the essential items and utilities. Second, on the direction of IMF, the government has substantially changed the income tax slabs, effective from July 01, 2024, which have adverse impacts on individuals, especially the salaried class. In this article, I am highlighting the potential impacts of such IMF led conditionalities on the lives of common people and salaried class.

## 2. Pakistan's History with IMF

Pakistan has been engaged with the IMF's financing arrangements 23 times since 1958. However, Pakistan has never been able to cope with its macroeconomic imbalances amid constrained growth performance. If we look at the data from the last three and a half decades, the rate of economic growth has been truncated for almost all of the time except the beginning of Pervez Musharraf era (2001 to 2005) when Pakistan received a substantial amount of US aid in return for being the front-line state in War on Terror (WOT). A similar situation exists with macroeconomic imbalances, as is shown in Figure 1 by the persistence of fiscal and current account deficits. The twin deficits cumulatively has not only led to the accumulation of public debt but they are also a significant drain on the budgetary resources as is shown by interest paid on public debt as percentage of GDP over time (see Figure 1).<sup>3</sup>

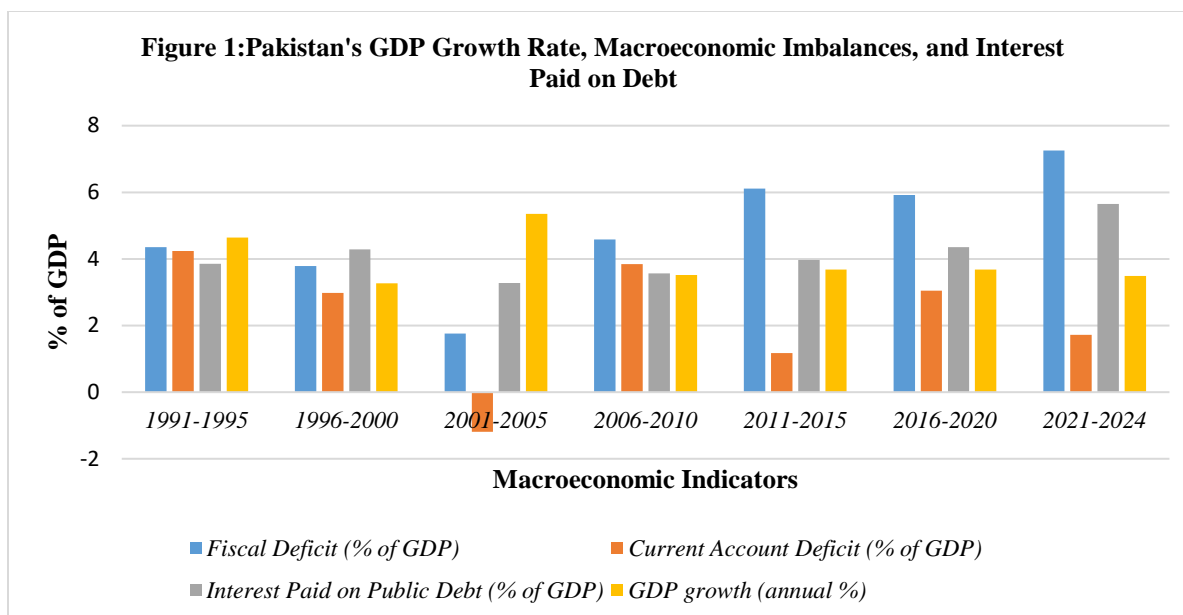
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<sup>1</sup> Pakistan's Financial Year begins at July 01 and ends on June 30.

<sup>2</sup> PDL is a fixed fee or tax that companies pay to the government on petroleum products.

<sup>3</sup> The current debt to GDP ratio in Pakistan is 82% while Pakistan is currently paying huge interest on its debt constituting almost 7% of GDP, 52% to total budgetary outlay, and 75% of tax revenue.



### 3. Energy Prices and 24<sup>th</sup> IMF Program

Energy is an important input to sustain industrial, agricultural, and commercial activities in addition to a consumable item for general consumers. Pakistan's power sector, though essential for economic development, is in a severe financial crisis due to its escalating circular debt. As of April 30, 2024, the total circular debt has reached to Rs.2.728 trillion, including payments owed to Independent Power Producers (IPPs) at Rs.1.854 trillion, payable to Generation Companies (Gencos) at Rs.109 billion, and loans amounting to Rs.765 billion parked at Government Holdings Private Limited (GHPL). As a condition to the proposed 24<sup>th</sup> program, the IMF wants to contain the circular debt to Rs.2.310 trillion by the end of current financial year. To meet this condition, the government has decided to pass on an additional burden of more than Rs.700 billion to consumers during the current fiscal year. Accordingly, the government has significantly increased the power tariffs from July 1, 2024, ranging from Rs.7 to Rs.12 per unit, depending on usage. On average, the increase for protected consumers stands at 46% compared to an average increase of 23.13% for non-protected consumers.<sup>4</sup> This would increase the electricity bill of protected consumers with 200 consumption units to Rs.4836.<sup>5</sup> Likewise, the bill of non-protected consumers using 200 units would surge to Rs.9030. Furthermore, the electricity bill for consumption of 300, 500, and 700 units would jump to Rs.15051, Rs.29880, Rs.44268, respectively, excluding the fixed capacity charges.<sup>6</sup> Similar would be the case for agricultural, industrial, commercial, and other consumers. The Finance Bill 2024 has also raised the PDL up to Rs.80 per litre on petroleum products to collect Rs.1.28 trillion. The rise in tariffs and PDL would have severe implications for inflation in the country as power prices have a cumulative impact up to 30% on inflation in

<sup>4</sup> Protected Consumers are those who are protected through government subsidies for consuming less 200 units per month consecutively for six months.

<sup>5</sup> A one-time exemption is given to protected consumers only for three months.

<sup>6</sup> These are estimated after incorporating 18% GST, Quarterly Adjustments, Fuel Costs Adjustments (FCAs).

Pakistan, with most affected are the prices of daily consumption products. The standards of living of majority of the population would be adversely affected, 40% of which are below the poverty line and are currently faced with around 24.5% inflation rate.

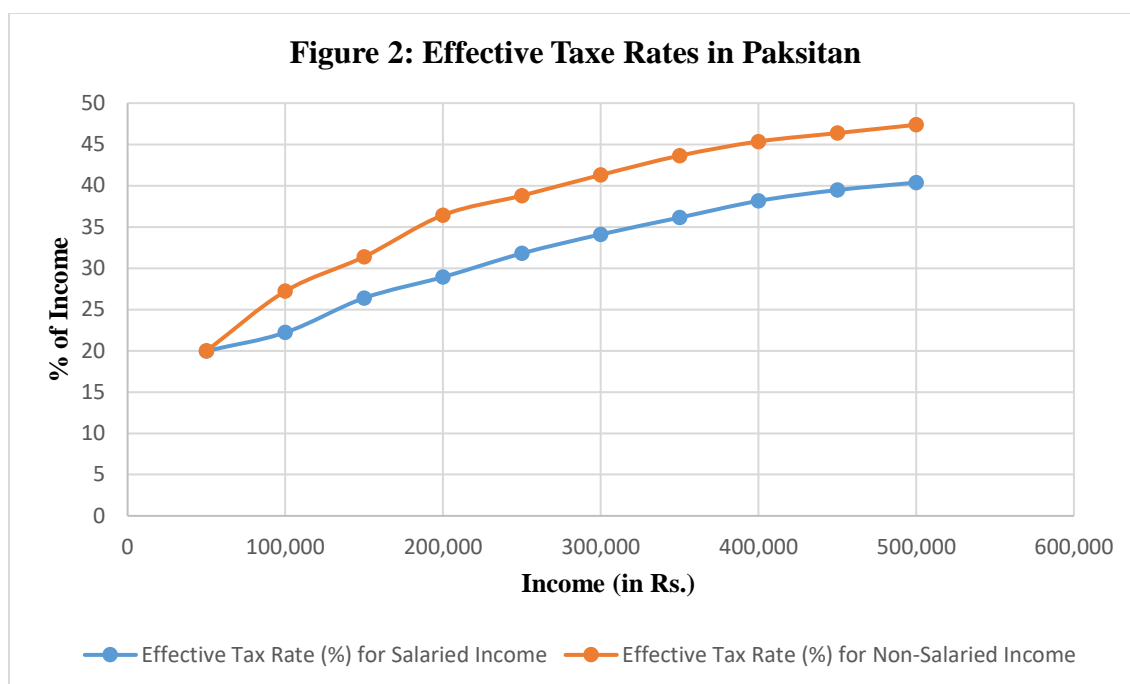
#### 4. Effective Tax Rates and 24<sup>th</sup> IMF Program

Pakistan's 24<sup>th</sup> financing arrangement with IMF also entails another conditionality of keeping the primary balance in surplus. This has led the government to create additional avenues for revenue. Along with soaring energy prices, the government approved new income tax slabs in Finance Bill 2024 which would significantly increase the effective rates of taxation across the board. As can be seen from Table 1, tax rates on the upper slabs for salaried and non-salaried incomes are raised to 35% and 45%, respectively. This is added by a wide-spread imposition of General Sales Tax (GST) (18%-25%), Federal Excise Duty (FED), and Custom Duties (CD). If we incorporate the cumulative incidence of all Indirect Taxes, the effective rates for upper slabs reach to 40.38% and 47.37% for salaried and non-salaried incomes, respectively (see Figure 2).

**Table 1: New Tax Slabs as of Finance Bill 2024-25**

Salaried Income		Other than Salaried Income (for individuals and associations of persons [AOPs])	
Income Range (in Rs.)	Tax Rate (in %)	Income Range (in Rs.)	Tax Rate (in %)
Income ≤ 600,000	0%	Income ≤ 600,000	0%
600,000 ≤ Income < 1,200,000	5% of the amount exceeding Rs600,000	600,000 ≤ Income < 1,200,000	15% of the amount exceeding Rs600,000
1,200,000 ≤ Income < 2,200,000	Rs30,000 + 15% of the amount exceeding 1,200,000	1,200,000 ≤ Income < 1,600,000	Rs90,000 + 20% of the amount exceeding 1,200,000
2,200,000 ≤ Income < 3,200,000	Rs180,000 + 25% of the amount exceeding Rs2,200,000	1,600,000 ≤ Income < 3,200,000	Rs170,000 + 30% of the amount exceeding Rs1,600,000
3,200,000 ≤ Income < 4,100,000	Rs430,000 + 30% of the amount exceeding Rs3,200,000	3,200,000 ≤ Income < 5,600,000	Rs650,000 + 40% of the amount exceeding Rs3,200,000
Income ≥ 4,100,000	Rs700,000 + 35% of the amount exceeding Rs4,100,000	Income ≥ 5,600,000	Rs1,610,000 + 45% of the amount exceeding Rs5,600,000

**Source:** Finance Bill 2024-25, Government of Pakistan



A detailed analysis of the effective tax rates in post budget 2024-25 scenario is given in Table 2 which indicates that the effective tax rates for the lowest decile of income is 19.98% even though there is no direct tax on this category. The average effective tax rates for other nine deciles of incomes are 33.1% and 39.8% for salaried and non-salaried incomes, respectively. So, the tax payers are being overburdened amid a cumulative federal spending of less than 5 percent of GDP on health and education which matter much to common tax payers.

**Table 2: Post Budget and Finance Bill (2024-25) Effective Tax Rates and their Impact**

Gross Income (in Rs.)	Disposable Salaried Income Per Month (in Rs.)	Disposable Non-Salaried Income Per Month(in Rs.)	Effective Direct Tax Rate (%) for Salaried Income	Effective Direct Tax Rate (%) for Non-Salaried Income	Incidence of All Indirect Taxes (%)**	Effective Tax Rate (%) for Salaried Income*	Effective Tax Rate (%) for Non-Salaried Income*
50,000	50,000	50,000	0	0	22.96	19.9752	19.9752
100,000	97,500	92,500	2.5	7.5	22.66	22.2142	27.2142
150,000	139,950	132,450	6.7	11.7	22.63	26.3881	31.3881
200,000	180,800	165,800	9.6	17.1	22.22	28.9314	36.4314
250,000	218,250	200,750	12.7	19.7	21.95	31.7965	38.7965
300,000	254,100	232,500	15.3	22.5	21.61	34.1007	41.3007
350,000	288,750	262,500	17.5	25	21.42	36.1354	43.6354
400,000	321,200	292,400	19.7	26.9	21.21	38.1527	45.3527
450,000	353,700	322,650	21.4	28.3	20.77	39.4699	46.3699
500,000	386,000	351,000	22.8	29.8	20.2	40.374	47.374

**Notes:**

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\*A generalized national saving rate of 13% is applied in order to calculate the net incidence of indirect taxes on expenditure only.

\*\*For Incidence of Indirect Taxes, the rates of Iffat and Khan (2022) are inflated by 1% in order to account for the increase in Sales Tax Rate from 17% to 18%-25% and Federal Excise Duty in February 2023 and March, 2023, respectively.

## 5. The Way Forward

The minimum wage in Pakistan as of Budget 2024-25 is Rs.37000 while, in practice, majority of the unskilled labour force in the informal sector is earning less than this amount. Moreover, the lowest decile of populace by income is liable to 19.98% incidence of indirect taxes and paying an electricity bill of more than Rs.2000 if they are protected and consuming less than 100 units of electricity. So, the lowest decile of income group is paying more than 25% of its earning in taxes and electricity bills. Is it sustainable in a country with 40% of the population is still living under the poverty line? I would say no and Pakistan has to initiate structural reforms to come out of the vicious circle of persistent macroeconomic imbalances and low growth trajectory. Yes, we need more revenue but revenue must be augmented by measures like removing preferential tax credits and exemptions, enhancing tax base and registration by simplifying the mechanism, introducing agricultural income tax, harmonizing the sales tax regime etc. For instance, tax expenditure which also includes the revenue foregone due to various exemptions and concessions in tax laws constitutes to be around Rs.3.9 trillion for outgoing fiscal year (2023-24) amounting around 54% of tax revenue. The exemptions are mostly awarded to the elite section of the society. The United Nations Development Programme (UNDP) in its National Human Development Reports (NHDR), 2020, has estimated that around Rs.2.6 trillion are spent each year on the privileges and benefits enjoyed by the powerful interest groups in Pakistan. Second, raising power tariffs is not the only solution to circular debt; rather other aspects such as renegotiating contracts with IPPs vis-à-vis fixed capacity charges, reducing generation cost, removing transmission and distribution losses<sup>7</sup>, and competitive practices in the energy market are the alternative that would provide durable solution to the problem of circular debt. Third, why do we inject money to inefficient SOEs as their annual losses reach to around Rs.2 trillion?<sup>8</sup> Reforms like corporate governance, market-based induction of CEOs, joint ownership structure, and privatization of irremediable SOEs must be initiated to have a permanent solution to the inefficient footprint of the state in the economy. Fourth, we need a sustainable exports led growth which can upscale our revenue potentials along with coping with our external sector shortages.

## 6. Conclusion

IMF programs along with short-term financing arrangements entail a bunch of conditionalities. On the eve of Pakistan's 24<sup>th</sup> financing arrangement, the IMF has confined the government to keep primary balance in surplus, curtail the circular debt, and mitigate the losses of SOEs which led the government to raise the tariff rates of electricity significantly along with introducing new income tax slabs. In this article, we have highlighted that these IMF guided measures would have dire consequences for the common populace and, at least, they are not sustainable in the long-run. We

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<sup>7</sup> Transmission and distribution losses stand at around 30% of the generation on average for all distribution companies.

<sup>8</sup> Currently, 212 State-Owned Enterprises (SOEs) are operating in Pakistan in various sectors.

need to move to durable solutions to mitigate our macroeconomic imbalances, on one hand, and look for sustainable exports led growth, on other.

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