# Economic Implications of The Prime Minister's Relief Package

**Dr. Hafiz A. Pasha**

## Pakistan Economy

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| Key Data | |
|---|---|
| KSE100 Index | 43,653 |
| KSE-All Share Value (PKRmn) | 5,266 |
| KSE-All Share Value (USDmn) | 29.0 |
| KSE-All Share Volume (Shmn) | 149.3 |
| Market Capitalization (PKRtn) | 7.5 |
| Market Capitalization (USDbn) | 41.9 |
| 1Year High | 48,726 |
| 1 Year Low | 42,780 |

Source: PSX, Next Research

The Prime Minister announced a big relief package on the 28th of February 2022. The country has been witnessing relatively high inflation since 2019. The loss of lives and livelihoods had been large after the five successive attacks of COVID-19 since March 2020. More recently, the upsurge in international commodity prices had has led to a spike in inflation to double-digit rates. The objective of this special report is to derive the economic implications of the Prime Minister's relief package. Section 1 describes the various components of the package. Section 2 derives the impact of the price reductions on the level of the Consumer Price Index. Section 3 attempts a quantification of the cost of the relief package and its implication on public finances. Section 4 focuses on the likely increase in demand for imports. Finally, Section 5 assesses the impact on the relationship with the IMF and the prospects for continuation of the existing IMF Extended Fund Facility.

### 1. THE RELIEF PACKAGE

The relief package announced on the 28th of February by the Prime Minister includes the following:

(i) A Rs 10 per liter reduction in the prices of petrol and diesel respectively. The prices will remain unchanged up to the next budget in June.

(ii) A Rs 5 per kwh cut in the electricity tariff. However, the types of electricity consumers to be covered has not been indicated. Here again, the assurance has been given that the new tariff structure would remain intact till the next budget.

(iii) Rs 407 billion subsidized loans over the next two years under the Kamyab Pakistan Program to farmers, youth and for low-cost housing.

(iv) Under the Ehsaas Program, increase in stipend from Rs 12,000 to Rs 14,000.

(iv) A graduate internship program with stipend of up to Rs 30,000 per month.

(v) Over 2.6 million education scholarships.

(vi) Rs 1 million free medical cover to all citizens by end of March 22, except to the population in Sindh.

(vii) Incentives for information technology sector with 100 percent tax exemption to both companies and freelancers.

Subsequently, the Prime Minister announced the granting of amnesty for investment in industry and five-year tax holidays on projects with investment by Pakistani expatriates in Pakistan.

### 2. IMPACT ON THE PRICE LEVEL

The impact of the reduction in the price of petrol, HSD oil and electricity is derived in Table 1.

**Table 1: Decline in Price Level due to Rs 10 reduction in price of petrol and diesel and Rs 5 in electricity charges**

| | Weight | Price Reduction (%) | Contribution to lower price level (%) |
|---|---|---|---|
| ***Urban Consumer*** | | | |
| Motor Fuel | 2.91 | -16.7* | -0.49 |
| Passenger Transport Services | 1.75 | -7.2** | -0.13 |
| Electricity Charges | 4.56 | -30.0*** | -1.37 |
| Indirect Impact[#] | | | -1.50 |
| ***Overall Impact on Price Level*** | | | ***-3.49*** |
| ***Rural Consumer*** | | | |
| Motor Fuel | 2.49 | -16.7 | -0.42 |
| Passenger Transport Services | 1.80 | -7.2 | -0.13 |
| Electricity Charges | 3.44 | -30.0 | -1.03 |
| Indirect | | | -1.75 |
| ***Overall Impact on Price Level*** | | | ***-3.33*** |

*On the assumption that though the crude oil price has risen as high as $130 per barrel, it will average $115 per barrel over the next four months.
** 40% of transport price is the fuel cost.
*** Assumed magnitude.
# Due to reduction in the transport cost on other consumer goods.

Source: PBS

Therefore, the likely impact on the price level in March 2022 and up to June 2022 of the relief package is in the range of 3.25 to 3.5 percentage points from the previous forecasts considering energy prices based on crude oil price of $115 per barrel. However, based on the actual prices of energy prevailing in February 2022, the impact of this relief package on inflation would be lower where prices of petrol and diesel have been reduced by around 6.3% on month-on-month basis.

### 3. IMPACT ON PUBLIC FINANCES

The Prime Minister has made the bold move of reducing domestic prices of petroleum products at a time of a continuing rise in the international crude oil price, which has risen as high as $130 per barrel from $96 per barrel on the 28th of February. The primary cause is the disruption caused by the Russia-Ukraine war. Estimates of the cost of the relief package have been made on the assumption that the price of crude oil will average $115 per barrel over the next four months. The resulting estimate of the cost of reducing price of motor spirit and diesel by Rs 10 per liter is given in Table 2.

**Table 2: Cost* of Bringing down Petrol and Diesel Prices**

| Assumption | Cost of Price Reduction by Rs 10 (Per later) | Cost of Rising International Price of Crude Oil (Per litre) | Volume of Consumption (Billion litres per month) | Total Cost (Rs in Billion) (For four months) |
|---|---|---|---|---|
| **International Crude Oil Price** | | | | |
| At $105 per barrel | 10.00 | 9.96 | 1.493 | 119.2 |
| At $115 per barrel | 10.00 | 21.06 | 1.493 | 185.5 |

**The cost is in the form of revenues foregone from the Petroleum Levy and Sales tax and higher price differential subsidy to the Oil Marketing Companies.*

The estimated cost of relief in prices of petrol and diesel is approximately Rs 185 billion in the four months from March to June on the assumption that the average international price of crude oil will be $115 per barrel during the next four months. There is also now the risk of circular debt emerging in the OMC sector. Turning to the cost of reduction in the electricity tariff, this will depend on which consumers benefit. The new tariff structure has not been notified yet by the NEPRA. However, the Ministry of Energy has apparently sought a supplementary grant of Rs 136 billion for the four-month price reduction. The Ministry has indicated that the tariff reduction will be applicable to domestic and commercial consumers, excluding consumers having Time of Use (TOU) meters or those categorized as lifeline consumers. Fuel charges adjustment will be capped at Rs 3.0966 per kwh for four months for eligible consumers, while the base rate will be reduced to Rs 5 per kwh. The relief will be given to domestic consumers from 200 to 700 kwh per month. The Kamyab Pakistan subsidized credit will probably be offered at the interest rate of 5 percent per annum, while the current average rate on advances by commercial banks is just above 11 percent. As such, the annual subsidy is 6 percent. The likely volume of credit extended from March to June is likely to be under Rs 70 billion. Including the provision for non-performing loans, the cost could approach Rs 11 billion. The size of the stipend in the Ehsaas Program is prosposed to be increased by Rs 2000 per family with coverage of 8 million families, costing thereby Rs 16 billion. Similarly, the cost of the over 2 million scholarships could approach Rs 30 billion, and the cost of graduate internships could be almost Rs 12 billion. Overall, a summary of the estimated cost of the relief package announced by the Prime Minister is given in Table 3.

**Table 3: Cost of the Prime Minister's Relief Package, March to June 2022 (Rs in Billion)**

| Cost of: | |
|---|---|
| • Price Reduction of Rs 10 of Petrol and Diesel | 185* |
| • Price Reduction of Rs 5 in Electricity Tariff | 136 |
| • Kamyab Pakistan and Ehsaas Program interventions and Scholarships for four months | 69 |
| **TOTAL** | **390** |

*Assumption that international crude oil prices will average $115 per barrel from March to June 2022.

Therefore, an estimate of the cost of the relief package is Rs 390 billion over the four-month period from March to June 2022. As such, it is a sizeable package. This does not include the cost of providing health coverage in Baluchistan which has been promised by the Prime Minister.

The question is how will this package be financed? According to the Ministry of Finance the cost will be covered by the following:

~ Reduction of development expenditure

~ Diversion of dividends of Government entities

~ Unspent Funds from the $1.4 billion IMF package

~ Cushion provided by the Mini-Budget in December.

These sources are mostly illusory in nature.

The Prime Minister has recently stated that the costs will be covered by the extremely rapid increase in FBR revenues. But the target has been raised for 2021-22 by almost Rs 300 billion to Rs 6.1 trillion, in view of the big shortfall likely in revenues from the petroleum levy of over Rs 400 billion. Therefore, the 'fiscal space' is limited and the Rs 390 billion cost of the relief package will correspondingly increase the size of the budget deficit by over 0.7 percent of the GDP.

## 4. IMPACT ON IMPORTS

The relief package runs the risk of raising the volume of imports when the trade deficit has already reached an all-time record level in the first 8 months of 2021-22. First, the almost 17 percent reduction in the domestic price of petrol and HSD oil could increase demand by almost 6 percent, given a price elasticity of -0.3. In effect this could raise the import of petroleum products by $200 million in the four months, March to June 2022. The rise in demand for electricity could be proportionately larger. The middle-class consumers account for 46 percent of domestic electricity consumption. The price elasticity of demand is close to -0.5. As such, the increase in overall demand for electricity over the four-month period will be almost 5 percent. This will necessitate additional coal, LNG, and furnace oil imports of $250 million. Therefore, the relief package could raise the level of these imports by almost $450 million from March to June. On top of this, there is the impact of the rise in the crude oil price to the assumed level of $115 per barrel. In the case of Pakistan for $5 higher price of crude oil, import of petroleum products rise by $1 billion. Therefore, these imports could be higher by $1.1 billion from March to June. Overall, this will imply some further worsening of the trade deficit by over $1.5 billion.

## 5. RELATIONSHIP WITH IMF

The relationship with the IMF is likely to run into heavy weather after the implementation of the relief package. According to the IMF Staff Review report, following the sixth review, the Government is committed to taking the following steps prior to the commencement of the seventh review in early-March 2022:

(i) Raising the petroleum levy by Rs 4 per month until it reaches the level of Rs 30 per liter.

(ii) Raising the electricity tariff by over Rs 3 per kwh and taking major steps to eliminate growth in circular debt in the power sector.

(iii) Phasing out the concessional housing credit facility.

(iv) Better targeting of the power subsidy.

(v) Avoiding any future tax amnesties.

(vi) No new preferential tax treatments or exemptions.

(vii) Preparation of draft legislation on reform of the personal income tax by end-February 2022.

(viii) Zero primary deficit in 2021-22, excluding grants.

The relief package effectively runs counter to all the above structural benchmarks and performance criteria agreed with the IMF for implementation. As such, the prospect for completion of the Seventh Review by end-March and release of $1 billion is extremely low. Overall, the Prime Minister's relief package brings down significantly the price level, imposes a cost of Rs 390 billion on the budget and increases demand for imports by $450 million. It violates many of the performance criteria and structural benchmarks agreed with the IMF for implementation prior to the forthcoming seventh review. This could lead to a temporary suspension or termination of the IMF program.