

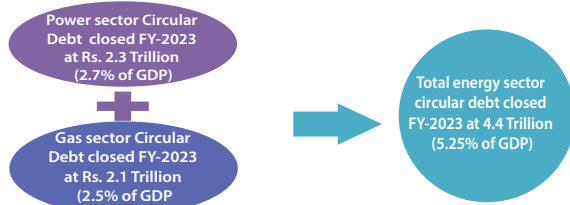


IMF and Energy Sector Reforms: Case Study of Pakistan

The Executive Board of the International Monetary Fund (IMF) approved Pakistan's 9-month Stand-By Arrangement (SBA) on July 12, 2023, totaling approximately US\$3 billion at the time of approval. The program aimed to address various priorities, including advancing structural reforms, notably in the energy sector's viability, governance of State-Owned Enterprises (SOEs), and enhancing climate resilience.

Recognizing the significance that the IMF places on tackling structural challenges in Pakistan's energy sector, we have provided a succinct overview of the IMF's evaluation of the sector and the agreed-upon reforms and future strategies between the Government of Pakistan and the IMF to address these structural issues.

Pakistan's circular Debt Position, FY23 (July 2022 to June 2023)



Source: Pakistan, First IMF Review under the Stand-by Arrangement, January 2024

Pakistan's power sector circular debt details, October 2023

Circular debt details (Rs. Billion)	Jul 2022 to June 2023	July 2022 to October 2022	July 2023 to October 2023
Payable to power producers	1,434	1,617	1,750
GENCOs' payable to fuel suppliers	111	91	96
Amount parked in Power Holding Private Limited	765	793	765
Total Circular Debt	2,310	2,501	2,611
Increase/(Decrease) in Circular Debt	+57	+249	+301
Break-up of Increase/(Decrease) in Circular Debt			
Budgeted but unreleased subsidies	Nil	74	8
Unclaimed subsidies	(70)	(10)	Nil
Interest Charges	143	54	45
(Power Holding Ltd. + Independent Power Producers)			
Pending Generation Cost (Quarterly Tariff Adjustment + Fuel Charge Adjustment)	250	103	110
Non-Payment by K-Electric	(53)	65	43
Distribution Companies losses inefficiency	160	61	77
Distribution Companies under recoveries	236	163	165
Other adjustments (Prior year recovery)	(447)	(254)	(147)
Sub-total (a)	220	256	301
Payment through fiscal space			
Power Holdings Limited principal repayments	(35)	(7)	Nil
Power Holdings Limited unpaid markup	Nil	Nil	Nil
Stock payments	(127)	Nil	Nil
Sub-total (b)	(162)	(7)	Nil
Total (a + b)	57	249	301

Source: Ministry of Energy (Power Division), Government of Pakistan

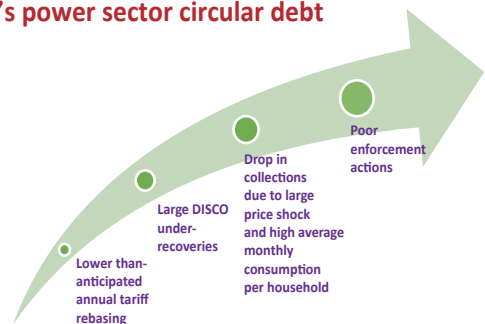
IMF praises efforts of Pakistan authorities to stem rise in Circular Debt



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In its First Review of IMF under the Stand-by Arrangement (SBA), IMF has lauded the efforts of last caretaker government in the power and gas sectors to stem the rise in Circular Debt (CD), which, combined, reached 5.25% of GDP at end of FY23.

Factors that are presently contributing to Pakistan's power sector circular debt



Source: Pakistan, First IMF Review under the Stand by Arrangement, January 2024

Addressing power sector CD: IMF has noted that Pakistan authorities notified the annual tariff rebasing in late July 2023, as well as monthly and quarterly tariff increases thereafter. Despite this effort, power sector CD reached Rs. 2.5 trillion at end-September 2023 (2.4% of GDP), due to lower than-expected recoveries, driven in part by a delay in the rebasing's billing application.

Addressing gas sector CD: IMF noted that Pakistan authorities increased natural gas tariffs first on November 08, 2023 and subsequently effective February 01, 2024, partly due to the fact that no gas tariff adjustments had occurred between September 2020 and January 2023.

Restoring energy sector viability in Pakistan

IMF believes “timely implementation of scheduled tariff adjustments and broader reform efforts” are critical to restoring energy sector viability in Pakistan. In particular, the Fund has recommended the following steps to manage Pakistan’s energy sector circular debt: -

Accelerating medium-term cost-reducing reforms

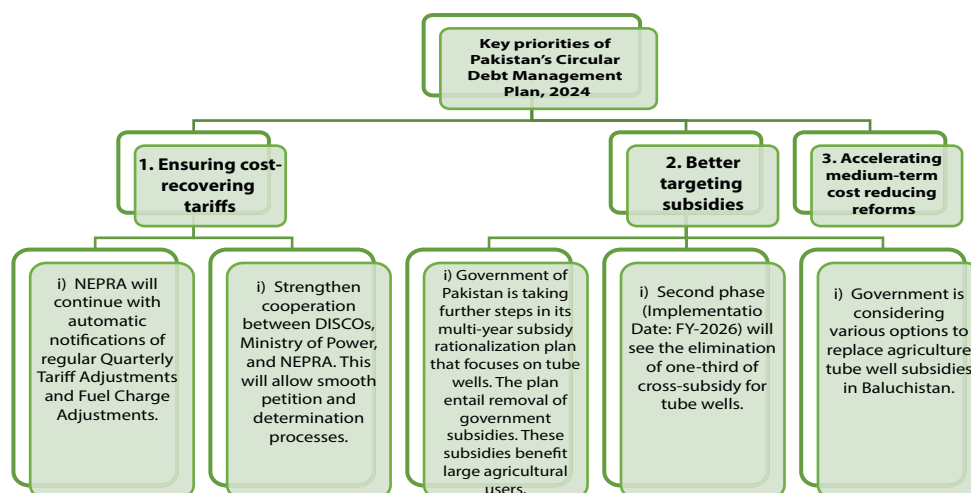
- i) Price rationalization to channel gas resources to the most efficient gas-based power generator (merit order principle).
- ii) Clearing unguaranteed CPPA-G arrears subject to renegotiating remaining power purchase agreements.

No	Power	Gas
01	Continued timely alignment of tariffs with cost recovery levels to prevent further annual “CD” accumulation and avoid further fiscal pressures while ensuring electricity generation. The progressive lifeline and protected slab tariff structure must be maintained to shield the vulnerable household consumers.	Automatic implementation of semiannual gas tariff adjustments.
02	Sustaining enhanced collections efforts initiated in September 2023 will complement tariff increases.	Complete phasing out of captive power usage.
03	To reduce high costs, improve distribution companies (“DISCOs”) performance, and increase competition and green energy. Reforms include:- (i) Improving price signals for inputs; (ii) Moving to private sector management of DISCOs through long-term concessions from 2024; (iii) Renegotiating the terms of remaining power purchase agreements; (iv) Continuing to convert debt of Power Holding (Private) Limited into cheaper public debt; (v) Expanding renewable energy capacity; and (vi) Improving transmission efficiency.	Establishing a level playing field by: (i) Eliminating cross-subsidies to fertilizer producers; and (ii) Removing favorable power rates currently offered to well-connected industries.
04		Presenting Circular Debt stock reduction plan.

Key priorities of Pakistan’s Circular Debt Management Plan, 2024

Pakistan has informed the International Monetary Fund (IMF) that the following are the key priorities of Pakistan’s Power Sector Circular Debt Management Plan, 2024: -

- iii) Convert expensive Power Holding Private Limited debt into cheaper public debt.
- iv) Improve DISCOs’ performance by bringing private sector participation. Initially, this could take the shape of long-term concessions arrangements and may culminate into ultimate divestment or privatization.



- v) Institutionalize anti-theft procedures.
- vi) Increase share of variable and cheaper renewable energy in the generation mix;
- vii) Refrain from netting out cross-arrears using "non-cash" settlements

Addressing the rising Gas Sector circular debt

Pakistani authorities notified the IMF that the escalating circular debt in the gas sector is attributed to the following factors:

- Accumulation of Re-gasified Liquid Natural Gas (RLNG) tariff differential since FY19;
- Non-implementation of regular end-user gas price adjustments in line with semi-annual OGRA determinations.

To address gas sector circular debt, Government of Pakistan has changed structural end-user gas tariff in February 2023. It has also raised gas prices first effective November 01, 2023 and subsequently in February 01, 2024.

Steps to be taken to address Gas Sector circular debt

- Implement the notification for OGRA's scheduled semiannual gas price adjustment within the mandated 40-day window.
- Reduce large preferential cross-subsidies across industrial and commercial users.
- Disincentivize gas use in captive power plants.
- Provide gas to power sector that is closer to cost-recovery.
- Equalizing rates between export and non-export industries.
- Implement structural gas pricing changes implied by Weighted Average Cost of Gas (WACOG) Bill thus allowing full cost recovery of imported RLNG.
- Implement cost reducing reforms (including measures to reduce Unaccounted for Gas (UFG) losses.
- Improve gas sector infrastructure, rehabilitate networks, and control theft.

Key takeaways from the interview of Dr. Musadik Malik, Pakistan's Minister for Energy

Minister for Energy, Dr. Musadik Masood Malik, provided the following remarks during an interview with a local TV channel on March 14, 2024:

- Pakistan's energy sector is facing an annual loss of Rs. 1,000 Billion.
- The implementation of the Weighted Average Cost of Gas is deemed necessary.

IMF has rejected the "new tariff rationalization and circular debt management plan"

IMF has rejected the "new tariff rationalization and circular debt management plan" claiming that "the proposal does not address the underlying problems of Pakistan's energy sector."

IMF Mission Chief Nathan Porter has said: "... it is essential for the government to focus on broad-based reforms, including to reduce the high cost of energy, improve compliance and reduce theft and line losses, end captive power, and fix the governance and management of the DISCOs, as well as keep up with regular tariff adjustments. In our view, the proposed plan does not address the underlying problems. In particular, the circular debt neutrality of the tariff rationalisation plan is doubtful and it would place a significant additional burden on vulnerable households. The circular debt 'reduction plan' entails fiscal risks given the chain of transactions involved and would also continue the use of supplementary grants which have placed a considerable burden on the fiscal accounts in recent years."

What was the tariff rationalization and circular debt management plan?

- It was proposed that power tariff for the industry be slashed between Cents 8.5-11.75/kWh from Cents 14 per unit through subsidy neutral proposal.
- Protected categories of consumers be loaded Rs. 50/- to Rs. 450 per month fixed charges to minimise cross subsidy.
- Energy sector circular debt stock of Rs. 1,268 billion be settled using funding from Government of Pakistan.

How was the scheme supposed to work?

- Assume the Government passes a grant.
- The grant was planned to be given to twin Suis (SSGC and SNGP) who would then be able to adjust their receivables by transferring them to pay off to gas suppliers (E&P Companies).
- Once the payments were to be received by suppliers, they would be able to pay out dividends to their shareholders who happen to be predominantly Government of Pakistan.

(Source: Business Recorder, February 07, 2024, My research)

- The current government is dedicated to reducing electricity costs.
- The Prime Minister has initiated a review of the future of DISCOS, contemplating potential privatization.
- Dr. Musadik Malik clarified that DISCOS are not slated for provincial control.
- The IMF dismissed the "tariff rationalization and circular debt management plan" as a mere "book adjustment."
- On the prospect of providing industrial sectors with electricity at Cents 9.0/kWh, Dr. Musadik Malik expressed doubt, suggesting, "I doubt the IMF will approve of such a subsidy."

About the Author: The writer is a Chartered Management Accountant and an Associate Member of ICMA. Currently, he holds the position of Senior Manager Research in the Investment Banking Division at Bank AL Habib Limited. Previously, he served as the Head of Research at AL Habib Capital Markets (Private) Limited. With over 18 years of experience, he has been involved in equities and macroeconomic research since 2005.