

The IMF in Pakistan*

C.P. Chandrasekhar

On February 4, after meetings held at Dubai for security reasons, an IMF team arrived at an agreement with officials from Islamabad, which would permit the release of the last-but-one tranche of \$497 million out of an SDR 4.393 billion billion loan package (around \$6.64 billion in exchange rates prevailing at time of sanction) under its Extended Finance Facility (EFF). The agreement came after the 10th review of economic performance and policy undertaken as part of the 3-year arrangement approved by the IMF Executive Board in September 2013.

The IMF in its press release has chosen to be complimentary. Besides stating that “economic activity remains robust,” the statement also said that the “mission welcomed the authorities’ strong program performance in the second quarter of FY2015/16. All end-December 2015 quantitative performance criteria, including the budget deficit target and the floor on the SBP’s (State Bank of Pakistan’s) net international reserves, have been met.” The only areas of mild disappointment seem to be that “measures pertaining to the energy sector reform and restructuring of loss-making public enterprises are yet to be implemented.”

Overall, the IMF presents a positive picture of economic performance. According to it, growth improved marginally from 4 per cent in 2014 to 4.15 per cent in 2015 and would rise to 4.5 per cent in 2016. Inflation is down from 8.6 per cent to 6 per cent and would fall further to 4.5 per cent. Foreign exchange reserves, which were down to the equivalent of six weeks’ imports or less, have now risen to the 3-month level.

What is remarkable is that a number of senior Pakistani economists, varying from Hafiz Pasha (a former Finance Minister) to Mohsin Khan (a former IMF hand), with an international track record and who might not always disagree with the IMF’s policies disagree with this assessment. According to the former actual growth is closer to 3.5 per cent and official estimates are an exaggeration. Inflation is down only because of the fall in international oil prices, which the government has been unable to exploit to accelerate growth. And accumulation of foreign exchange reserves is the result of excess borrowing from abroad that has led to unsustainable debt levels.

Significantly, economists like Pasha even question the official figure of 5 per cent of GDP for the fiscal deficit on the government’s budget, saying that it is likely to be closer to 8.5 per cent. The official figure, they argue, has been kept low by treating privatization receipts and grants as revenue, by keeping off-budget energy arrears payable to private power generators, placed at over \$6 billion in 2015, and by delaying tax refunds and requiring prepayment of certain taxes.

In sum, the charge is that the IMF is being “lenient” with the government of Pakistan. This differential attitude, when compared to what the IMF demands in many other contexts, is not new. In fact, Pakistan is a country that IMF has been keen to have as borrower. Pakistan received its first EFF loan in 1988, just two years after the facility was created. Starting with that, Pakistan has had the “benefit” of access to financing under 12 IMF programmes, as compared with one for India, three for Bangladesh and two for Sri Lanka. This is despite the fact that in almost all those instances the government in power has failed to deliver on crucial targets set by the Fund, especially with respect to reducing the fiscal deficit. As a result 11 out of these 12 programmes were stalled midway, ostensibly because consecutive Pakistani governments were not intent on realising IMF targets with regards to revenue generation and deficit reduction. Yet each time, after a short gap and when Pakistan was in need of more funding to stave off a balance of payments and/or growth crisis, the IMF was back at the table, negotiating a new facility.

Analysts have for long seen a US hand behind this unusual behaviour. A December 2012 [working paper](#) from the Asia Research Centre of the London School of Economics authored by two erstwhile IMF hands from Pakistan (Ehtisham Ahmad and Azizali Mohammed, "Pakistan, the United States and the IMF: Great game or a curious case of Dutch Disease without the oil?") argues that: "A history of Pakistan's relations with the IMF (and the Bretton Woods Institutions in general) cannot be told without reference to the complex and changing role played by the United States, especially since the mid-1980s when the Reagan administration stepped up responses to the Soviet Union in Afghanistan." Whenever expenditures on strategic grounds were needed they flowed in the form of bilateral commitments by the US government. But when political considerations led to the cessation of bilateral assistance, the IMF stepped in, even if temporarily.

This political (mis)use of a multilateral institution meant that Pakistan benefited from "exceptionally favourable conditionality and flexibility in giving waivers, on not meeting even soft conditionality standards." This led in turn to successive Pakistani governments avoiding demands to raise the woefully inadequate level of its tax revenue to GDP ratio, which was below 11 per cent in all but one year since 2000 and as low as 8.7 per cent in one. It also meant a kind of dependence on American and/or multilateral support that affected the growth process, given the volatility of such support for political and other reasons.

Not that the US and the IMF got nothing in return. They have managed to persuade domestic elites in Pakistan to put the country firmly on a path of neoliberal development path with an emphasis on liberalization of trade and foreign investment rules, domestic deregulation, and large scale privatization of public assets. Dependence on foreign financing has led to a convergence in thinking between domestic elites in Pakistan and the US and multilateral policy establishments on the need for a neoliberal policy environment, so that the IMF is not criticised for achieving nothing out of its long and close engagement with that country.

The implications of that policy regime for objectives like employment generation and poverty reduction, besides health and education, hardly need emphasizing. Given pre-existing inequalities, including in land ownership, a market driven strategy can hardly be inclusive. Human development advance, if any, must be ensured through enhanced public spending. With the government strapped for resources, social expenditures in the budget have been too little to make any difference.

Neoliberalism has worsened the fiscal problem and affected growth directly as well. To start with, since it relies on private initiative to raise investment and growth, the government is committed to a tax regime that is lenient and incentivises private sector activity. Revenues are expected to come from widening the tax base and improving compliance—as elsewhere that has not worked. Second, the weighted average tariffs imposed on manufactured imports fell from 44 per cent in 1998 to 12 per cent a decade later, undermining domestic manufacturing in Pakistan. Third, revenues from taxes on international trade have shrunk from as much as 28 per cent of total revenues in the early 1990s to an average 7-8 per cent currently. That loss has obviously not been compensated with revenues from direct taxes, affecting the spending power of the state adversely. With the tax-GDP ratio low, and some pressure to keep deficits from registering explosive increases, the state's ability to stimulate growth has been eroded, but alternative drivers of demand such as exports have not emerged.

As a result, the expenditures that capital flows helped sustain proved crucial for raising demand and driving growth. With Pakistan being a beneficiary of such flows, it is not surprising that the GDP growth rate in Pakistan has averaged close to a creditable 5 per cent in the whole period since 1947. Low rates of growth in some years have been compensated by higher rates in others, especially when US-directed flows of foreign investment, foreign

debt and grants have been abundant. The problem is that since capital flows have been volatile, annual growth rates have also been extremely volatile in Pakistan.

Given that history, the current economic situation is disturbing because despite the most recent IMF loan and despite a substantial step up of US expenditures to address the perceived threat from terrorism originating in the region, growth has slowed since 2008. After recording a compound annual GDP growth rate of 3.9 per cent over 1991-2003, Pakistan experienced a mini-boom with growth over 2003-07 being as high as 7.9 per cent. But between 2008 and 2014 the growth rate has come down to around 3 per cent per annum.

An important explanation seems to be a collapse of foreign investment inflows from a high of \$7 billion in 2007 to \$760 million in 2012 and \$2.3 billion in 2014. The fact that the IMF most often turned a blind eye to violations of fiscal deficit targets did not help. A higher fiscal deficit does not mean considerably higher expenditure, if the tax to GDP ratio is low or falling.

Privatization and the absence of public investment have affected growth from the supply side as well. Nothing illustrates this better than Pakistan's electricity crisis with major shutdowns that hold back production and infuriate consumers. Starting in the 1990s the government decided to encourage private investors to set up capacities to generate electricity. To encourage them the government entered into power purchase agreements at lucrative prices. But this implied that the price at which the government required the public distributor to sell power to its clients would result in large losses unless subsidies make up the difference. Unable to finance those subsidies, a government strapped for cash could not meet payments due to the power producers. The latter have cut back production aggravating the power shortages created by inadequate capacity creation. Power producers in turn have delayed payments to the fuel procuring agencies that supply them their principal input.

The result has been a combination of severe power shortages and a circle of debt that is estimated at \$6 billion or more. With new investments not forthcoming and utilization of existing capacity at 40 to 50 per cent, power shutdowns last up to 20 hours in some areas. This has led to riots. It also results in production disruptions and lower growth. Spending is crucial to relax this supply constraint.

Thus, what the Pakistan government needs to do is to raise tax rates and tax revenues, which can finance enhanced public expenditure, especially public capital formation. The government is, however, seeking to borrow itself out of the problem and is looking for new credit to pay off the debt it owes power producers and the fuel companies. But for a country that has built up a huge debt burden by doing that more than once in the past, that is not even a short term solution.

To conclude, Pakistan's role as an on-and-off strategic partner of the US and its allies has undermined its ability to find an independently funded and driven growth strategy. This is what the IMF, given its own role in this triangular relationship, conceals in its optimistic assessments of the performance of the Pakistan economy. Meanwhile, in Pakistan, the government waits for another round of strategic funding from the US and the proposed "game-changing" \$46 billion investment by China in the [Pakistan-China Economic Corridor](#) to materialize and resolve its current crisis.

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