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POLICY REPORT

IMF Loans: Source of Reform or Easy Money?

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IMF Loans: Source of Reform or Easy Money?

An overview of the current economic issues of Pakistan

During the last decade, Pakistan's economy tackled several challenges: the energy crisis, terrorism and political instability. These stifled the country's capacity to focus on macroeconomic stability resulting in current account and external account imbalances. The newly elected government of Pakistan took office in August 2018 and elected Imran Khan, chairman of the winning political party, as the 22nd prime minister of Pakistan. Having severely criticized the economic reforms agenda of governments over the last 22 years, this new government promised the public to come up with a strong mandate for economic reforms. These reforms vowed to not only focus on economic growth and development but also to improve the living standards of the poor. The Pakistan Tehreek-e-Insaaf (PTI) government guaranteed to increase the tax base, reform the Federal Bureau of Statistics, generate private sector activity, establish a 5 million unit housing project and improve foreign direct investment and remittances.

However, ever since the PTI government took office, like their predecessors they have claimed that Pakistan's treasury is in fact empty. They expressed worry over the country being in need of at least 18 billion dollars. This would then enable the government to finance a severe short fall in foreign exchange arising from mounting import bills and debt financing, triggered by a sharp fall in exchange rate in term of dollars.

Pakistan landed into a macroeconomic crisis as early as March 2018 when the overall public debt burden reached Rs 28,297 billion on March 31, 2018. Amounting to every citizen being indebted with Rs1,36,700 on average.[1] While there has been a continuous rise in import bills, the export to GDP ratio has declined from 11.2% in 2007 to 7.2% in 2017.[2] To pacify the yawning gap between exports and imports the PTI government has charted down a strategy. One instance is of the government trying to assist exporters by

[1] With total population reaching 207 million according to latest census by Pakistan Bureau of Statistics
[2] http://www.finance.gov.pk/press_releases.html

discovering new markets overseas and working to improve the ease of doing business rankings. Furthermore, Pakistanis employed overseas have been requested to send their money back to Pakistan through formal banking channels so that country's FOREX can be increased. However, with Pakistan's low credit rating, the government knows it is difficult to raise any amount above two to three billion dollars from international markets. Another external factor which seem to have aggravated the financial crisis within the country is the rapid rise in oil prices in international markets.

Despite PTI's initial reluctance to approach international agencies for short term economic bailout plans, the Finance Minister has entered negotiations with IMF, requesting for another bailout program. More than 35 percent of Pakistan's public debt is external, and most of this debt is taken from multilateral lending institutions like IDP, ADB, IMF and World Bank etc. This policy brief critically analyses Pakistan's approach to an IMF bailout program. It further sheds light on the historic context to provide a rationale, if any, in benefitting to stabilizing Pakistan's macro economy through availability of short term lending support by IMF in coming months.

Is IMF the only option?

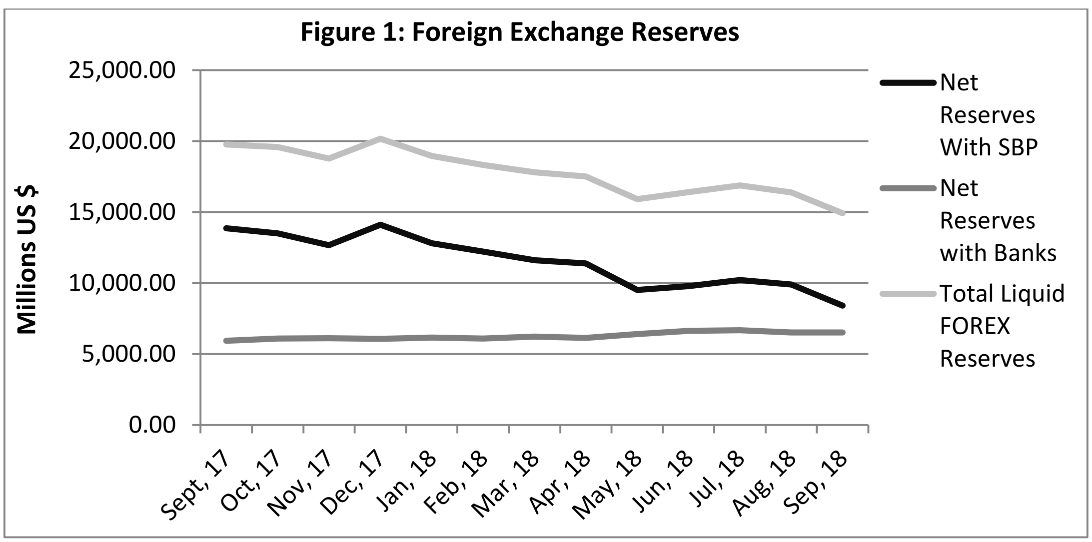
Currently Pakistan's balance of payment accounts are in a precarious situation. The value of Pakistan's Rupee has depreciated by 26 percent while interest rates have increased by 2.75 percent during the period of December 2017 to October 2018. Furthermore Pakistan experienced a decline in liquid foreign exchange (FOREX) reserves from \$15,913.0 million to \$14,920.7 million. The decline of \$992.3 million was reported by the State Bank of Pakistan (SBP) during the third week of September 2018 (Table 1).

The commercial banks' reserves also reported a decline from \$6,403.3 million to \$6,512.0 million during the past 4 months. Net reserves of SBP declined from \$ 9,509.7 million to \$ 8,408.7 million. Low FOREX reserves have caused a slowdown in Pakistan's economy putting at risk its economic growth targets for the fiscal year 2019.

Table 1: Foreign Exchange Reserves (Million US $)

Months	Net Reserves With SBP	Net Reserves with Banks	Total Liquid FOREX Reserves
Sep,17	13,857.2	5,918.0	19,775.2
Oct, 17	13,491.4	6,092.3	19,583.7
Nov, 17	12,660.7	6,113.0	18,773.7
Dec, 17	14,106.9	6,070.2	20,177.1
Jan, 18	12,793.7	6,162.0	18,955.7
Feb, 18	12,227.3	6,089.2	18,316.5
Mar, 18	11,602.3	6,210.5	17,812.8
Apr, 18	11,389.4	6,130.4	17,519.8
May, 18	9,509.7	6,403.3	15,913.0
Jun, 18	9,789.0	6,618.4	16,407.4
Jul, 18	10,211.4	6,679.7	16,891.1
Aug, 18	9,885.2	6,504.7	16,389.9
Sep, 18	8,408.7	6,512.0	14,920.7
			Source: *State Bank of Pakistan*

Over the past year, a declining trend can be witnessed in Pakistan's foreign exchange reserves given in Figure 1 below.



The PTI government is under pressure to generate resources to fund the external account obligations of the state. According to IMF the government's attempts to get financial help from friendly countries like Saudi Arabia, Abu Dhabi and China are not enough to address the $18 billion deficit in foreign exchange causing a sharp devaluation of Pakistan Rupee; adversely affecting the balance of payment situation further. According to the Finance Minister, the government might still be in need of an additional $12 billion after support from friendly states. Pakistan’s fiscal deficit has reached 6.6 percent and the current account deficit is increasing at $2 billion a month.[3]

However, before the 2018 elections, PTI government was not in favor of foreign loans, especially borrowing from the IMF. It considered debt as one of the reasons for Pakistan’s current macroeconomic crisis. Often dubbed as a debt trap, which the country finds itself in after every IMF bailout. But uncertain macroeconomic outlook paired with low FOREX reserves, Pakistan has little option but to borrow externally to improve its deteriorating balance of payments situation.

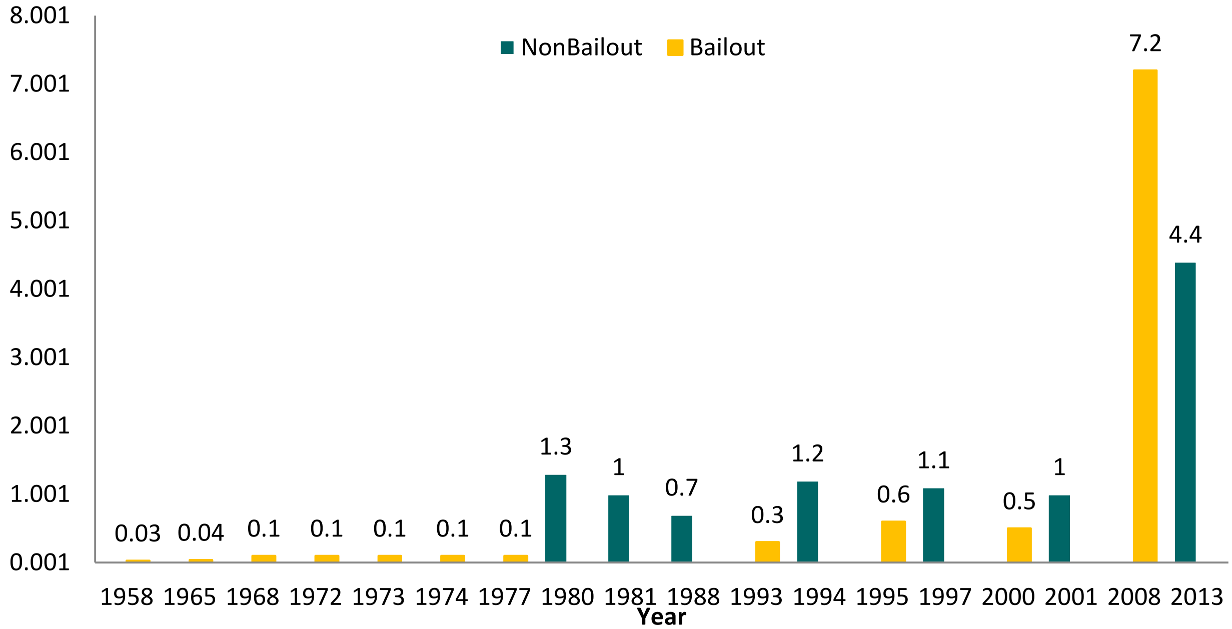
In order to bridge the current account gap, PTI government has approached the IMF for a $16 billion bailout package. The IMF package seems to be the only available option for the Pakistani government, which claims it to also be the last bailout package.

Pakistan has so far taken eighteen IMF programmes, of which eleven were acquired under democratic governments while the remaining under military regimes. Pakistan has taken 21 loans out of which 12 loans were classified as bailouts and the rest of them as non-bailout programs.

Starting 1958, $27 billion have approximately been borrowed from the IMF. Figure 2 illustrates the agreed amounts of bailout and non-bailout loans extended to Pakistan by the IMF. It must be noted that one Special Drawing Rights (SDR) currently equals $0.71, while in the past one SDR ranged $0.6 to $0.7.

[3] http://www.finance.gov.pk/press_releases.html

Figure 2: IMF Loans to Pakistan (USD in Billions)



Source: *International Monetary Fund (IMF)*

Criticism on IMF Program

Over the years, IMF programmes have been criticized in Pakistan by economists, politicians, and public alike. Some of the criticisms aimed at the IMF appear to be genuine concerns addressed towards the policy outcomes of their conditionalities. Some such concerns are mentioned in the following paragraphs.

First and foremost criticism is that the IMF follows "one-size-fits-all methodology" to tackle the macroeconomic policy challenges and remedies. Therefore it does not take into account the individual political and monetary limitations of borrowing nations.

Furthermore the strict IMF loans' conditions hinder the autonomy of the borrowing nations; for example the strict corrective macroeconomic policies enforced by the IMF not only fail to address a crisis at hand but may have exacerbated the situation further. Such policies lead to distributional imbalances and disregard the social facets of a nation's prosperity. It can be seen from the example of South Korea; a country enjoying a budget surplus equating four percent of the GDP and a low inflation rate of 5 percent during 1994 to 1996. IMF demanded the implementation of similar strategies and polices in North Korea. Policies which were implemented in nations with had high inflation during the 1997

Asian Financial crisis. Consequently, it led to an increase in interest rates, and South Korea went into recession which prompted more bankruptcies and unemployment. Before IMF intervention South Korea had the second most robust macroeconomic position amongst the Organization for Economic Co-operation and Development (OECD) nations.

One of the prevalent IMF conditions imposed on borrowing nations is to remove regulations from their financial markets which often leads to flow of capital market investments: exposing these markets to the risk of speculative financial bubbles.

IMF bailouts packages are sometimes riskier and a cause of moral hazard because people act irresponsibly. In light of the fact that they will be saved if things turn out bad for them. The Mexican peso emergency of 1995 was mostly the consequence of such strategies. Governments with bad economic management practices are assured that IMF bailout packages would bring them out of crisis and hence protect them from being penalized for their poor performance. Furthermore it urges speculators to keep making risky-speculative wagers, leading to instability of national economies.

IMF is also criticized because of its interference in the country’s macroeconomic and structural matters e.g. governance issues, corporate administration and so forth. Another criticism is that the least developing member countries are provided with the option to either accept the loan with conditions or without conditions but developing and emerging economies are not provided with such options by the IMF.

The critique of IMF programs notes that once a nation gets dependent on IMF advances, it just continues to borrow more and more and hence never escapes the cycle of borrowing. We have examples of Argentina, Greece and Pakistan. The critique seem to hold true for few more nations. Nevertheless, there are many other examples where nations borrowed from IMF and were able to successfully break the cycle of borrowing e.g. India. India took IMF loans on harsh conditions back in 1992 when it had severe balance of payment issues but from that point forward it didn't take any IMF loans. Iceland, Ireland and numerous other countries, that experienced the 2008 financial crisis, effectively paid their advances and are presently among the highest performing economies internationally. So one can also put forward the conjecture that the IMF loan is not to be blamed for what ails the macro economy of the borrower. But the policies, that a country implements, actually decide its financial and economic prosperity.

Relevance of IMF bailout in recent national debate on Pakistan's economy

United States (US) being the largest contributor to the IMF, controls 17.68% of the vote, had claimed that this program would be used to pay off the Chinese debt. However Pakistan rejected this claim stating the **"**US claim is 100 percent wrong.**"**[4] In the beginning, Pakistan did not receive positive signal from the US when Pakistan went to the IMF for the bailout programme. US State Department considered CPEC related Chinese debt to be responsible for Pakistan's recent economic crises, a claim was rejected by both PTI and PML-N. Former Prime Minister, Nawaz Sharif, also rejected the US claims and told that the reimbursement of Chinese loan would commence after 2022 and that too would not exceed$ 2 billion per annum.

On the other hand US had expressed its desire to examine Pakistan's debt on account of CPEC related projects. Pakistan has agreed to share information that has already been made public through various publications of the Ministry of Finance. The IMF bailout program would be expected to last three years and its terms and conditions would be finalized with the IMF delegation, due to meet in November 2018.

Pakistan's foreign exchange reserves were $18.9 billion in September 2016 which declined to $8.4 billion in September 2018. Keeping in view the shortfall of the foreign exchange reserves and current account deficit, this bailout seems to be necessary and unavoidable. In the interim, Pakistan would develop its capacity by progressively reducing trade deficit, raising foreign remittances, improving tax revenues, and finding other revenue generation modes in an attempt to steer clear of the IMF programme in future.

Conclusion

PTI has traditionally been critical of Pakistan approaching the IMF for a bailout package. In face of a balance of payment crisis due to severe short fall of nearly $18 billion in

[4] During the meeting of Asad Umar (Finance Minister of Pakistan) with the IMF's Managing Director Christine Lagarde on October 11, 2018 held in Indonesia

FOREX, the finance ministry looked for help from Pakistan's traditional friends in the Middle East and China. A visit by Imran Khan himself in October 2018 to KSA did help to get commitments of nearly $6 billion in short term financing. However the recent visit to China, also the first official visit of Imran Khan to Pakistan's strategic partner, was not successful in terms of obtaining any monetary help. Though Pakistan was expecting financial help in range of another $6 billion. So Pakistan now has little option other than to reach out to IMF for the bailout package. The Finance Minister has already approached international financial institutions and placed a formal request on with them on 11th October 2018.

Meeting the IMF conditions and criteria is necessary in order to avail the package. Usually the conditions imposed by IMF are universal in nature. The immediate fallouts of an IMF bailout package are rising inflation and devaluation. However, in addition to structural reforms expected to be implemented by Pakistan's government, the IMF's conditions might include reforming the Federal Board of Revenue, decentralization and devolution of power, improving competitiveness of local industry, more and fair competition among domestic and international firms. These conditions seem necessary for Pakistan to stabilize its macroeconomic outlook.

Discussions related to IMF bailout package are expected to start in first week of November 2018. A real challenge for the existing government is to make sure that basic economic and structural reforms are implemented to guarantee that this cycle of approaching an IMF program at regular intervals is broken permanently.

"To correct the underlying imbalances, fiscal and monetary actions needed to be undertaken without delay."[5]

[5] The Finance Minister, Asad Umar, said during the annual meetings of World Bank / IMF at Bali