PRIME

Policy Research Institute of Market Economy

آزاد معیشت۔ خوشحال پاکستان

POLICY REPORT

# ANOTHER BAILOUT OR A DEBT TRAP: REASONS FOR GOING TO IMF?

OCTOBER 2018

**PRIME INSTITUTE**

functions to perpetually optimize Pakistan's economic governance through public policy research.

We aim to work towards ***An open, free and prosperous Pakistan.***

**Policy Research Institute of Market Economy (PRIME)** is a public policy think tank striving for an open, free and prosperous Pakistan by creating and expanding a constituency for protective function of the state and freedom of the market. PRIME was established in Islamabad in 2013, and since then, it has published on a wide range of issues including trade, tax policy, housing, public debt and energy crisis.

**PRIME Policy Report (PPR)** is a publication that provides insight into both micro and macro levels of the economy. It is a one stop information hub for various stakeholders aspiring to understand the policy dynamics, business prospects and interpretation of key economic challenges.

**Author**
Beenish Javed – Research Associate

**Published by**: Policy Research Institute of Market Economy (PRIME)
October 2018


**For inquiries, contact:**
Email: info@primeinstitute.org
Mobile: 0333 0588885

**Mailing Address:**
PRIME Institute Office 401 Gulistan Khan House,
82-East Fazal-ul-Haq Road, Blue Area
Islamabad, 44000, Pakistan.
Tel: 00 92 (51) 8 31 43 37 – 38 Fax: 00 92 (51) 8 31 43 39

**www.primeinstitute.org**

# *Another Bailout or a Debt Trap: Reasons for Going to IMF?*

## Introduction

Any government performs better when acting relatively autonomous in execution of daily affairs of national and local governance. Democracy ensures that the campaign promises made by leading political party are translated into active policy making that may carry favorable results for empowering the common citizen. This strengthens democracy and legitimizes governance institutions in the eyes of the voters. However, due to external account challenges, democratic or autocratic governments have been approaching International Financial Institutions (IFIs) for short and long-term assistance. In this perspective, International Monetary Fund (IMF) has been instrumental in disbursement of short-term loans to Pakistan several times over the past 50 years. These loans were provided to bailout the country to finance its high budget deficits and trade imbalances. Nonetheless, these short-term loans are accompanied with conditionalities that stifle the autonomy of the government.

Over the years, devaluation of Pakistani Rupee has worsened the repayment capacity of subsequent governments due to mounting debt levels and debt servicing. The citizens and popular media are increasingly becoming critical of financial assistance from IFIs as if these donor agencies are to be blamed for accumulating debt burden of Pakistan. On the other hand, governments have been finding it convenient to blame the IFIs and their stringent conditions when they do not deliver on campaign promises, calling financial assistance as a *'debt trap'*. This policy report takes a look at the reasons for Pakistan to approach IMF again after facing severe short fall of nearly US$18 billion in its balance of payments. Before getting elected to the office of premiership, Imran Khan had been critical of previous governments approaching IMF for a bailout but once in power with economy taking a deep plunge, his Finance Minister Asad Umer was asked to swiftly approach the IFIs for assistance.

Since 1958, the country has signed 21 loan agreements with the IMF, 12 of which can be categorized as bailouts. From past few decades, an interesting trend can be observed in terms of the IMF programmes such that their restructuring guidelines are becoming more stringent and detailed covering not only the economic sphere but also the social and political spheres. In this regard, the opinion of the biggest donor to IMF, that is the US, becomes a key stakeholder in policy making and decision making with Pakistan even at strategic level. Of late, the US State Department made a statement in the press that the recent attempt of Pakistan to seek an economic bailout was on account of its borrowing for projects it has undertaken in last 3 years through China-Pakistan Economic Corridor (CPEC). Though Finance Ministry categorically denies this impression as incorrect, there is a need to understand what indeed is the financial arrangement between Pakistani and Chinese authorities within the agreement and where would the IMF loan, if made available, stand.

In 2013, Government of Pakistan signed the key agreement for CPEC which is an amalgam of various projects that are currently under progress pertaining to physical infrastructure, development of Gwadar, modernization of railways, establishment of Special Economic Zones (SEZs) and energy projects. However, this project worth US$ 57 billion[1] is raising numerous questions regarding its feasibility. Many consider it to be a debt trap while others perceive it as a major reason behind the bailout.

In order to illustrate a clear picture, this report will present an overview of the nature of public debt, the history of IMF programmes contracted by Pakistan, status and financial liabilities of the CPEC. In doing so, it will shed a light on the question that is recently being raved, that is, *"Is Pakistan seeking IMF bailout to payback the CPEC debts or for the macroeconomic challenges?"* The report aims to present the ongoing debate of CPEC's impact on future external payment obligations on factual basis rather than on opinions.

## Public Debt Profile

Between 2013 and 2018, domestic, external and total public debt have increased in absolute terms. However, in terms of GDP, all three kinds of debt reveal a mixed trend. Moreover, the size of domestic debt exceeds that of external debt throughout the period under review (see Table 1).

Essentially, domestic debt comprises of permanent debt (medium and long- term), floating debt (short-term) and unfunded debt. Permanent debt encompasses market loans, federal government bonds and prize bonds. On the other hand, floating debt consists of Market Treasury Bills (MTBs), used for replenishment of cash through outright sale of MRTBs to banks while unfunded debt includes General Provident Fund, postal life insurance and saving schemes. From Table 2, it can be observed that majority of the domestic debt is in the form of floating debt while the amount of permanent and unfunded debt is relatively low.

In contrast, encouragingly within external debt, bilateral and multilateral debt forms the largest component (medium and long-term). The loans from bilateral and multilateral sources are primarily availed for removing structural bottlenecks from the economy. Loans from IMF constitute US$ 6.1 billion while short-term loans contribute only US$ 0.9 billion in external public debt.

[1] Financial Liabilities under CPEC, Policy Brief, CPEC Centre of Excellence.

**Table 1: Profile of Public Debt**

| (Rs. in trillion) | | | | | | |
|---|---|---|---|---|---|---|
| **Years** | **Domestic Public Debt** | | **External Public Debt** | | **Total Public Debt** | |
| | Rs. trillion | % of GDP | Rs. trillion | % of GDP | Rs. trillion | % of GDP |
| 2013 | 9.5 | 42.5 | 4.8 | 21.4 | 14.3 | 64.0 |
| 2014 | 10.9 | 43.4 | 5.1 | 20.1 | 16 | 63.5 |
| 2015 | 12.2 | 44.5 | 5.2 | 18.9 | 17.4 | 63.3 |
| 2016 | 13.6 | 46.9 | 6.1 | 20.8 | 19.7 | 67.7 |
| 2017 | 14.9 | 46.5 | 6.6 | 20.5 | 21.4 | 67.0 |
| 2018(P) | 15.4 | 44.9 | 7.4 | 21.5 | 22.8 | 66.3 |

Note: (P) implies Provisional and values have been rounded off and converted into Rs. trillion.
Source: Pakistan Economic Survey 2017-18, Ministry of Finance.

**Table 2: Composition of Public Debt**

| | **Domestic Debt (Rs. trillion)** | | | **External Debt (US $ billion)** | | |
|---|---|---|---|---|---|---|
| **Year** | **Permanent** | **Floating** | **Unfunded** | **Short term** | **Medium & Long term** | **IMF** |
| 2017 | 5.0 | 7.6 | 2.8 | 0.9 | 55.5 | 6.1 |

Source: Pakistan Economic Survey 2017-18, Ministry of Finance.

## Historical Overview of IMF Programmes

The IMF programmes can be divided into two types; the first being the General Resource Account (GRA) and the second, the Poverty Reduction Growth Trust (PRGT). The former has been designed for lending to high and middle income countries facing economic distress while the latter, for lending to lower middle and low income countries at a comparatively low interest rate to curb poverty. The IMF offers a total of 10 programmes under GRA and PRGT. Out of these, so far Pakistan has acquired loans under 4 programmes. Of the 21 loan agreements with the IMF, Pakistan has entered into 12 bailouts or Stand-by Agreements (SBAs) which are short to medium term loans liable to be paid back between 3 to 5 years. Stand-by Agreements fall under the GRA, meaning they are essentially not formulated for poor countries, unlike the PRGT. Out of the remaining 9 loans, 4 were given under the PRGT to help boost growth and reduce poverty.[2]

Over the years, the trend in IMF programmes has been changing. That is, the programmes are becoming longer and larger whereby the pay-out period is increasing and the IMF is becoming more involved in economic, social and political matters. For instance, all the 7 programmes contracted by Pakistan between 1958 and 1977 were for one year. Interestingly, these were all bailouts or SBAs. Similarly, between 1980 and

[2] Sajid, H. (2018). Pakistan's 60 year history with the IMF in one chart. Date accessed: October 22, 2018. Retrieved: https://www.samaa.tv/news/2018/10/pakistans-60year-history-with-imf-in-one-chart-hs/?fbclid=IwAR3FIj1nzSl_NiUQeb-5fM80iqOUvvcxX-K6KS8k5yvTq46KQOtM3cNeFpU

1995, 6 of the 7 programmes were between 1 to 2 years long. However, 5 of the 6 programmes undertaken between 1997 and 2013 were for relatively longer durations (3 years).[3]

Recently, the incumbent government has officially sought to avail the IMF bailout for the 13th time. In other words, it would be the 22nd loan that Pakistan will acquire from the IMF. However, the ongoing debate is whether and if the loan is being availed for bailing the country out of the macroeconomic crisis or for paying back the Chinese debt. In order to clarify this, it is imperative to look at the financial liabilities under CPEC.

## Financial Liabilities under CPEC

Of late, the value of CPEC has increased from US$ 57 billion to US$ 62 billion.[4] These projects are being financed through the Public Sector Development Programme (PSDP), Foreign Direct Investment (FDI) and loans obtained from Chinese commercial banks and Chinese government.[5] To be specific, the energy projects are being financed through the foreign investments that are offered a 17 percent[6] rate of return on equity as well as the loans that are being taken by the Chinese companies from the China Development Bank and China Exim Bank, against their own balance sheets. They would service this debt from their own earnings without any obligation on the part of the Pakistani government. On the other hand, the infrastructure projects under CPEC are being financed through government-to-government loans. These loans are concessional with maximum 2 percent interest payable over the next 20 to 25 years. However, these loans fall under the liability of Government of Pakistan. Moreover, SEZs, Gwadar and industrial development projects are being financed through a mix of grants such as Public-Private Partnership (PPP) and government-to-government loans.

Technically, there are three distinct financial liabilities under CPEC namely fiscal, foreign exchange and contingent liabilities. The fiscal liabilities comprise of debt servicing liabilities accrued by local investments financed through Chinese commercial and government-to-government loans. Moreover, returns on equity guaranteed by Government of Pakistan also fall under fiscal liabilities. On the contrary, foreign exchange liabilities (other than imports) include repatriation of profits in case of FDI projects and loans repaid to Chinese donors in US dollars. On the other hand, contingent liabilities

[3] Ibid.
[4] Siddiqui, S. (2017). CPEC Investment pushed from $57b to $62b. Date accessed: October 23, 2018. Retrieved: https://tribune.com.pk/story/1381733/cpec-investment-pushed-55b-62b/
[5] Umer Zahid, Financial Analyst, Ministry of Finance.
[6] Husain, I. (2017). CPEC and Pakistani Economy: An Appraisal. Date accessed: October 23, 2018. Retrieved: http://cpec.gov.pk/brain/public/uploads/documents/CPEC-and-Pakistani-Economy_An-Appraisal.pdf

constitute potential liabilities that may arise from unexpected falls in profit rates of FDI projects that is lower than the amount guaranteed by the Government of Pakistan.[7]

Apparently from Table 3, bulk of the investment is in the form of FDI followed by the loans from Chinese entities. Hence, it would be safe to conclude that not all investments under CPEC are Chinese. As far as the progress of CPEC is concerned, Table 4 reveals the current status of various projects, and as evident, few have been completed while the remaining are expected to be concluded by 2019 to 2020. The entire portfolio is expected to be operational by 2030.[8]

**Table 3: Investments under CPEC**

| Investment Category | Value (US$ Billion) |
|---|---|
| FDI | 35.3 |
| Commercial and government-to-government loans from Chinese entities | 12.8 |
| Chinese grants | 0.4 |
| Non-Chinese foreign loans | 0.5 |
| GOP's own resources (revenue or domestic debt) | 8.2 |
| Total | 57.2[9] |

Source: Financial Liabilities under CPEC, Policy Brief, CPEC Centre of Excellence.

**Table 4: Status of CPEC Projects**

| Project Type | Number of Projects | Completed Projects |
|---|---|---|
| Energy Projects | 23 | 7 |
| Infrastructure Projects | 8 | 0 |
| Gwadar Projects | 12 | 1 |
| Rail based Mass Transit Projects | 4 | 0 |
| New Provincial Projects | 6 | 0 |
| SEZs Projects | 9 | 0 |
| Social Sector Development Projects | 4 | 2 |
| Other Projects | 3 | 1 |

Source: CPEC Quarterly Magazine, Spring Issue, Vol: 2, 2018.

According to Planning Commission's statement[10], *"CPEC is not imposing any immediate burden with respect to loan repayment and energy sector outflows. All the debt related outflows will be outweighed by the resultant benefits of the investments to the Pakistan economy."* Nonetheless, no explicit figure was quoted regarding the magnitude of

[7] Farooq, N. *Financial Liabilities under CPEC.* Policy Brief. CPEC Centre of Excellence. Date accessed: October 18, 2018. Retrieved: https://cpec-centre.pk/wp-content/uploads/2018/03/Financial-Liabilities-under-CPEC-updated-3.pdf

[8] Husain, I. (2017). CPEC and Pakistani Economy: An Appraisal. Date accessed: October 23, 2018. Retrieved: http://cpec.gov.pk/brain/public/uploads/documents/CPEC-and-Pakistani-Economy_An-Appraisal.pdf

[9] The value of CPEC investments have increased from US$ 57 billion to US$ 62 billion. (See, Siddiqui, S. 2017. CPEC Investment pushed from $55b to $62b. Date accessed: October 23, 2018. Retrieved: https://tribune.com.pk/story/1381733/cpec-investment-pushed-55b-62b/)

[10] CPEC debt burden: What is the actual debt and repayment schedule? Times of Islamabad. Date accessed: October 23, 2018. Retrieved: https://timesofislamabad.com/12-Oct-2018/cpec-debt-burden-what-is-the-actual-debt-and-repayment-schedule

outflows or their timeframe. In a newspaper article, Pakistan's former ambassador to the WTO, Dr. Manzoor Ahmad emphasized that *"Chinese debt merely accounts for 10 percent of Pakistan's total loan repayments."*

Given this backdrop, it becomes evident that CPEC loans are long-term loans that may not necessarily inflict significant and immediate burden on Pakistan's debt profile.

## Rationale behind IMF Bailout?

As far as the rationale for seeking IMF bailout is concerned, there are different perspectives. For instance, the spokesperson from the US State Department, Heather Nauert claimed Chinese loans are the reason for Pakistan's economic slowdown. Precisely stating, *"I think part of the reason that Pakistan found itself in this situation is Chinese debt and the fact that there is debt that governments have incurred that they maybe thought wouldn't be so tough to bail themselves out of, but has become increasingly tough."*

In response, Pakistan's Finance Minister Asad Umer countered the US State Department's statement and pointed that the country is willing to disseminate *"the normal debt-related information about CPEC with the IMF."* He further added, *"The terms of Chinese loans are attractive."*[11] Essentially implying that CPEC debt is not accountable for the rising debt burden and crippling state of the economy.

This implication is discernible from State Bank of Pakistan's statement whereby in 2017, out of the US$ 5 billion that went into the debt servicing, only US$ 500 million went to China. In other words, the Chinese loans account for approximately 10 percent of the total loans.[12] Thus, these loans cannot be held accountable for the current Balance of Payment crisis.

On the other hand, the US Secretary of State, Mike Pompeo said that, *"the US would be keeping the track of the IMF funds to see if they would be utilized for paying off the Chinese debt."*[13] He further added that, *"There's no rationale for IMF tax dollars, and associated with that American dollars that are part of the IMF funding, for those to go to bail out Chinese bondholders or China itself."*[14]

[11] Rana, S. (2018). Pakistan to share CPEC debt details with IMF. The Express Tribune. Date accessed: October 23, 2018. Retrieved: https://tribune.com.pk/story/1825065/1-finance-minister-denies-advocating-seeking-imf-bailout/

[12] Ahmad, M. (2018). CPEC- debt trap or game changer? The Express Tribune. Date accessed: October 23, 2018. Retrieved: https://tribune.com.pk/story/1820520/2-debate-cpec-debt-trap-game-changer/

[13] IMF warns Pakistan of risks of working with China. Date accessed: October 23, 2018. Retrieved: https://www.scmp.com/news/asia/south-asia/article/2167574/pakistan-poised-seek-bailout-imf-stabilise-economy-chinese-debt

[14] 'Totally Wrong' to link IMF bailout with CPEC, Pakistan tells US. Pakistan Today. Date accessed: October 23, 2018. Retrieved: https://www.pakistantoday.com.pk/2018/08/01/totally-wrong-to-link-imf-bailout-with-cpec-pakistan-tells-us/

In response, the Finance Minister clarified that, *"the country would seek an IMF bailout to stabilize its teetering economy and replenish its dwindling foreign exchange reserves."*[15]

In support, the IMF's resident representative to Pakistan, Teresa Daban Sanchez stated that, *"The IMF remains committed to helping Pakistan and its people."*[16]

For further clarification, focal persons from Ministry of Finance and CPEC Centre of Excellence were approached to state the facts behind the IMF bailout and CPEC debts. In this regard, following information was retrieved:

- Out of the US$ 62 billion, an estimated US$ 48 billion is in the form of investment in the commercial projects by the Chinese companies in Pakistan which does not contribute to Pakistan's external debt liability. It is only around US$ 15 billion that is accrued as a loan. Therefore, CPEC's contribution in total public debt is not as significant as perceived. Additionally, the CPEC debt is to be paid over a period of 20 to 25 years at a concessionary interest rate of 2 percent. The repayments will commence in 2021 with about US$ 300 to 400 million to be paid annually over a span of 25 years. Therefore to suggest that Pakistan is seeking IMF bailout to payback the Chinese debt would be a misleading statement. Instead, the IMF bailout is being sought to tackle the current macroeconomic issues: balance of payments crisis and depleting foreign exchange reserves.[17]

- The financial arrangement of CPEC is such that the energy-related projects are essentially foreign investments that are carried out under Independent Power Producers (IPPs) mode. On the other hand, infrastructure development is being financed through the PSDP and government concessional loans while the Gwadar port, airport and hospitals are grant-based projects. As for the nature of Chinese loans, they fall under the category of long-term loans and contribute only 10 percent in the total loan portfolio. Presently, the country is facing severe shortfall of foreign reserves and trade imbalance thus, the IMF bailout is being sought for tackling these challenges.[18]

[15] Yu, X. (2018). IMF warns Pakistan of risks of working with China. South China Morning Post. Date accessed: October 23, 2018. Retrieved: https://www.scmp.com/news/asia/south-asia/article/2167574/pakistan-poised-seek-bailout-imf-stabilise-economy-chinese-debt

[16] Rana, S. (2018). US opposes IMF bailout for Pakistan. The Express Tribune. Date accessed: October 23, 2018. Retrieved: https://tribune.com.pk/story/1770653/1-us-opposes-imf-bailout-pakistan/

[17] Umer Zahid, Financial Analyst, Ministry of Finance.

[18] Ahsan Abbas, Senior Research Fellow, CPEC Centre of Excellence.

## Conclusion

Over the years, serious concerns have been raised regarding hasty borrowings from domestic and foreign entities and its manifestation in the form of rising debt burden and the consequences for the economy. Each time the country faced an economic crisis, it relied on International Financial Institutions for assistance. So far, Pakistan has reached out to the IMF 21 times for acquiring loans. Currently, the country is faced with serious macroeconomic challenges most notably, yawning current account and budget deficit, inflation and depleting foreign exchange reserves making the IMF bailout imminent.

However, recently, an ambiguity has been stirred by the US Secretary of State when he warned Pakistan that they will be keeping an eye on the IMF funds in order to ensure they are not utilized for paying off the CPEC debt. In order to clarify the ambiguity, this policy report analyzed the current public debt profile and the contribution of CPEC debt. It also shed a light on the history of IMF programmes contracted by Pakistan and their nature as well as the financial liabilities accrued under CPEC. The analysis reveals majority of the foreign debt owing to multilateral foreign institutions and the Paris Club members while the contribution of Chinese loans is only 10 percent. Moreover, the nature of Chinese loans is such that they are essentially long-term loans, being provided at concessional interest rates (2 percent) and, are to be paid over a period of 20 to 25 years commencing from 2021.

The premise that Pakistan is a sovereign nation and should have no external pressure in terms of its economic policies depends entirely on democratic governments as to how they align the institutions to address basic good governance practices. These practices may include better economic management to promote private sector activity and fiscal responsibility; ensuring rule of law by strengthening national judicial system to provide speedy and effective justice to masses without discrimination; and practicing democratic precedence at national and local level to bring the voices of all citizens within law making institutions.

The IMF bailout packages come with guidelines and their involvement at policy level is limited to very generic solutions to Pakistan's governance issues. The complexity of local anthropology usually prevents effective implementation of IFIs funded and promoted interventions. Efforts to implement IFIs recommended interventions in letter and spirit by the relevant agencies and ministry often results in outcomes that are not according to perceived objectives and mostly the issues remain unsettled. For instance, despite a lot of rhetoric to implement Millennium Development Goals (MDGs) in the last decade, Pakistan had failed to meet the goals. Similarly, the progress on Sustainable

Development Goals (SDGs) is lackluster at best. Commitment to restructuring the economy has not been forthcoming and most of Pakistan's industries lack business competitiveness as they are faced with poor implementation of government regulations and facilitation. Therefore to blame IMF for what ails the economic structure and related governance environment would be unjust. It is always good to determine policies with consideration to the needs of public welfare and that requires work on government's part to make economic, political and social governance more effective.