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IMF's first review

The first quarterly review report of the twenty-third International Monetary Fund (IMF) programme for Pakistan was uploaded on its website on 23 December, four days after Board approval that is a requirement for a tranche release prompting Pakistan's economic team to claim that Pakistan is on a trajectory where there would be no need for a twenty fourth IMF programme.

With programme completion not till September 2022, a good 33 months away, a definitive conclusion is premature however the first review does provides insight into the IMF's and the government team leaders' mind-set. The transition to a market determined exchange rate has been orderly and inflation has started to stabilize mitigating the impact on the most vulnerable groups of the population, the review states - claims that can be challenged on three counts.

First, the transition to a market-based exchange rate was smooth due to overwhelming support from Prime Minister Imran Khan, support extended without a careful assessment of the fact that the rupee was already undervalued at the time of the transition (in May 2019) and was further undervalued in June and July (around 10 percent) and stood at a little over 5 percent in October 2019. The Prime Minister's support therefore may dwindle in months to come as the manufacturing sector has been increasingly clamouring that an undervalued rupee is an impediment to import of inputs (raw materials and semi-finished products) which, in turn, has raised their costs of production to a level that disables them from competing internationally. The manufacturing sector's top business houses have held meetings with the Prime Minister and the Chief of Army Staff (so much for equality of all) and conveyed their concerns and while so far the government continues to support an undervalued rupee yet in the event that the industrial units downsizing followed by closures continues with a consequent impact on employment opportunities (already around 50,000 have joined the ranks of the unemployed) the government may be compelled to back down. The IMF notes that "anecdotal evidence suggests unemployment is rising," a source of evidence that Hammad Azhar, while referring to an anecdotal survey carried out of Islamabad cited in a Business Recorder editorial dated 8 November 2019, dismissed in his rebuttal as "the above merits no response."

An undervalued currency encourages exports, a policy employed by China. However Pakistani exports have only marginally increased in total terms, though the economic team claims that volume of exports has increased - an increase unlikely to be sustained as rice and sugar exports to China were a one-off. Without a clear empirical (as opposed to anecdotal) linkage between the undervalued rupee and exports in Pakistan's economy an undervalued rupee has increased the government's indebtedness (each rupee decline in value vis a vis the dollar raises the country's indebtedness by 100 billion rupees).

What is also critical is that without an improvement in governance in key utility sectors, particularly power, the onus is on raising tariffs whose impact on productive sectors and households is fast becoming unbearable.

Not surprisingly economic team leaders state in the report that "high frequency indicators, including the large scale manufacturing sector (down by 5.6 percent year on year in September 2019) continue to point to weakened activity but there are some encouraging signs in several sectors benefiting from our policies. This includes a recovery in agricultural output, increased production in import competing industries and volume growth of traditional export sectors." With cotton target revised downward already, price of vegetables on the rise, and no details provided as to which import competing industries have raised production, this claim is laughable. The IMF team's assessment is that "business environment is improving…Pakistan needs to focus on ensuring that changes underway are perceived as permanent to instill confidence and rekindle private sector investment." Unfortunately there is no evidence of any improvement in business environment and neither is there any visible improvement in SOE performance, sixteen months after the PTI government took over power and six months after the country went on a Fund programme.

Secondly, the claim that inflation is stabilizing mitigating the impact on the most vulnerable is inaccurate. The Fund's assumption here is the budgeted outlay for subsidies, social sector development and Public Sector Development Programme would mitigate the impact on the vulnerable. During the first quarter (July-September) subsidies were not released, less than one percent of the budgeted amount was released for social sector and 8.8 percent for PSDP. Besides food inflation has risen by over 20 percent, a major expenditure item of the vulnerable, and with an undervalued rupee petroleum and product imports are more costly with transport costs having risen tremendously. The IMF report does mention that five indicative targets for end September were missed notably targeted cash transfers (under Benazir Income Support Programme), power sector arrears, health and education (as approved in the budget) but added that these will be met by end-December 2019. One wonders where the money to meet these targets would come from: loot sale of state owned entities, mini budget or data manipulation or an amalgam of all three.

And thirdly, the current account deficit has fallen with over 70 percent decline in imports, a major achievement of the monetary policies – an undervalued rupee and the 13.25 percent prohibitively high discount (prohibitive for the productive sectors which the IMF claims is 'appropriate' as the positive real policy rate is consistent with SBPs medium term inflation objective'). The Fund would be well advised to undertake an empirical study for Pakistan on the linkage, if any, between inflation and the discount rate.

The Prime Minister together with his two economic team leaders has rightly claimed success in reducing the current account deficit. The IMF mission leader for Pakistan has noted that "some adjustments have been made to the export import composition of the current account but without any major substantial change in the total current account deficit share of GDP expected this year."

The main burden of getting out of the debt trap rests with raising revenue which makes Shabbar Zaidi, Chairman of the Federal Board of Revenue, a key player in achieving the programme objectives. It is unfortunate that he is constantly being undermined by Adviser to the prime minister on finance Dr Hafeez Sheikh through being given "unrealistic" targets and in one instance by Jehnagir Tareen who negotiated a settlement with traders who had threatened countrywide strike action if the condition of the use of CNIC for all transactions above 50,000 rupees was not lifted – a decision deferred for a second time till February. Exemptions demanded by exporters as well as other sectors if extended would as per the IMF "undermine broad basing efforts and lead to a less equitable distribution of the adjustment."

It is unfortunate that the pressure groups that are the target of the FBR have been able to derail attempts to widen the net, the rise in the number of filers is reportedly of those legally allowed not to file returns for example those retired, widows, students and their objective was to take advantage of lower withholding rates for filers.

To conclude, there is many a slip between the cup and the lip and while the economic team leaders may be sipping the beverage in their plush offices the rest of the public, especially the vulnerable, are playing tag the pony with their eroding rupee earnings blindfolded.