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Back to the IMF

Ever since the new government took charge of the state of affairs, the debate on whether the new government should go to the IMF or not for a bailout package began within the government and in the Economic Advisory Council of the Government. An overwhelming majority supported the idea that Pakistan should go to the IMF for balance of payments support. However, few argued otherwise and were of the view that Pakistan should learn to live without the IMF and that because of the changing geo-strategic environment, it should make every effort to avoid going to the IMF. Pakistan has now decided to seek financial support from the IMF. The Staff level agreement has been reached. Pakistan now needs to complete some prior actions before the deal is presented to the Board of the IMF. This article explains as to how the new IMF programme would affect the economy, the people and the government.

From the view point of the IMF, whenever a country faces balance of payments crisis it is because of the excessive demand prevailing in the economy. In other words, aggregate demand (C+I+G+X-M) exceeds aggregate supply (Y). When a country approaches IMF for financial support, it is asked to pursue an old fashion Stabilization Policy which is also known as demand management policy or austerity policy. The IMF believes that by curbing aggregate demand through various policy instruments, the country can restore a balance with aggregate supply.

There are three key instruments of Stabilization Policy. These include: i) floating/flexible exchange rate policy, ii) tight monetary policy and iii) tight fiscal policy. Let me describe how these policies work in reality. The country would be askedto pursue floating or flexible exchange rate policy which invariably leads to devaluation. Devaluation, by definition, is inflationary as all the landed costs of imported items in local currency increase. To counter inflationary pressure, the Central Bank immediately tightens monetary policy by increasing the discount rate which, in turn, increases overall interest rates in the economy. Higher interest rate discourages private sector investment.

Tight fiscal policy on the other hand, prevents the government from spending more. Given the committed nature of spending such as interest payment, defense, running civil administration and subsidies in which there is little or no flexibility, the axe of spending cut falls invariably on development expenditure. Cut in development expenditure means that public sector investment also declines. Thus, higher interest rate discourages private sector investment and cut in development spending means decline in public sector investment, therefore total investment as percentage of GDP declines. Investment being the critical input to economic growth, lower investment slows economic growth. Pace of job creation depends on the pace of economic growth. Slower economic growth slows the pace of job creation and hence, rise in unemployment and poverty. Slower economic growth slows revenue generation as well.

Tight monetary policy to counter inflationary pressures leads to higher discount rate and the rise in overall interest rate. Higher interest rate increases the cost of financing government's budget deficit, which, in turn, increases interest payment, and hence, total expenditure. Devaluation also increases dollar denominated public debt in rupee term which increases overall public debt. Given the rise in interest rate, high public debt increases interest payment, current expenditure and hence, total expenditure. Slower economic growth slows revenue generation and given the rise in total expenditure, it increases budget deficit which is against the objective of the IMF policy. Higher budget deficit forces government to borrow more to accumulate more public debt. The economy enters into debt trap.

IMF policy of stabilization in fact puts the country into a debt trap. Once the country goes to the IMF for a balance of payments support and implement the stabilization policy, it never comes out from the crisis. The IMF Program is therefore not a stabilization program, rather it is a destabilization program in which investment and growth slowdown leading to the rise in unemployment and poverty which give birth to social unrest in the country. It also increases the country's debt and as such the country never gets out of the clutches of the IMF Program. Hence, slower growth, rising unemployment, more inflation and more debt are the natural outcomes of the IMF Program. The country's macroeconomic policy remains in the hands of the IMF and the country's Ministry of Finance loses policy making initiative.

Pakistan has been under the IMF Program for most part of the decade (2008-18). It has pursued the IMF dictated Stabilization or demand management or austerity Program all along the decade. In the words of the Managing Director, IMF (Christine Lagarde) as posted on iMF direct, September 1, 2016, "the longer demand weakness lasts, the more it threatens to harm long-term growth as firms reduce production capacity and unemployed workers are leaving the labour force and critical skills are eroding".After 10 years of Stabilization Policy, Pakistan witnessed its economic growth slowing, unemployment situation worsening, fiscal and current account deficits deteriorating, public and external debt growing astronomically and foreign exchange reserves depleting.

The persistence of low economic growth (3.8% p.a.) over the last one decade has failed to create enough jobs for the new entrants in the job market, as well as for those who were already in the pool of unemployed. People in general and youth in particular, found it extremely difficult to get jobs. Those remaining unemployed for a longer duration became unemployable, with all its social and economic ramifications. Unemployment rate surged to 8.5 percent, a 13-year high in 2014-15, youth unemployment rate has also increased to over 10 percent by 2017-18. This reflected the worsening state of the labour market under the IMF programme.

Tight fiscal policy as an instrument of the IMF dictated Stabilization Policy meant to reduce fiscal deficit. Pakistan remained under the IMF Program for most part of the last decade (2008-18) but failed miserably in reducing fiscal deficit. During 2008/09 to 2012/13, Pakistan sustained a large budget deficit, averaging 7.0 percent of the GDP. Massive manipulation of statistics took place during 2013/14 to 2016/17. Adjusting for these manipulation implies a fiscal deficit in the range of 7.0 to 8.0 percent of GDP.

Fiscal indiscipline remained the hallmark of the previous two regimes that remained under the IMF Program. As percentage of the GDP, the public debt surged from 58.4 percent to 74.4 percent and external debt and liabilities increased from $46.2 billion to $95.3 billion during the period. The readers would recall that Pakistan also remained under the IMF Program during the decade of the 1990s. This decade was termed as "lost decade for Pakistan" by independent economist (Dr Ishrat Husain).

Pakistan accumulated $49.1 billion of external debt during the decade of 2008/18 and it added $17.4 billion in the decade of the 1990s. Altogether, Pakistan added $66.5 billion external debt and liabilities during the two lost decades for Pakistan. In other words, Pakistan added 70 percent of total outstanding external debt and liabilities during the two 'lost decades' under the IMF programme.

Pakistan is now entering into another IMF programme, perhaps from July 1, 2019 for over three years. In so doing, it will be implementing the same 1980s vintage Stabilization Policy. Should we expect a different result this time? Can Pakistan afford to experience yet another decade of 'lost opportunities'?

Pakistan is now entering into the 22nd Program with IMF and 5th one since 2000. Three out of the four programmes with IMF were fully completed since 2000. The last programme (2013-16) was completed in September 2016 and was termed as "successful". In fact, the IMF launched its Annual Report for the Year 2018 in Davos and was very upbeat on Pakistan. The Report said that "Pakistan can manage without the IMF support".

Surprisingly, within two years of the "successful completion" of the IMF Program in September 2016, we were told that Pakistan has no option but to go to the IMF once again. If a patient suffers a relapse so soon after remission, we have every right to question the authenticity of the clean bill of health given by the IMF in the first place. Since Pakistan is once again going to the IMF fold, it is legitimate to question the efficacy of the medicine given to the patient thus far. Will the same medicine prove to be effective during 22nd time or will history repeat itself?

What is in store for Pakistan under the 22nd IMF Program? Slower economic growth in the range of 2.5-3.5 percent during the next three years will continue. The economy would fail to create enough jobs for the new entrants and hence the pool of unemployed, particularly youth and educated youth will keep on rising along with the rise in poverty. Budget deficit will rise, resulting in the rise of public debt. Ill-conceived additional tax measures and policies pertaining to power and gas sector will put tremendous burden on the poor and fixed income groups. Prime Minister's initiatives; 10 million jobs and 5 million low cost housing units may not succeed under the high interest rate environment. It is feared that the new program will be extremely painful and may not see its successful completion.

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