

## **Return of IMF**

The IMF has returned once again to Pakistan. Since the country's joining the membership of the IMF in July, 1950, it has entered into 21 Programmes with the Fund. Therefore, on average, a balance of payments problem arising once in every three years has required support from the IMF, the so-called 'global lender of last resort'. This time the need has arisen after a gap of only two years as the last Programme, the Extended Fund Facility (EFF), came to an end in September 2016.

The reality is that the EFF was one of the few Programmes that Pakistan completed successfully, in sharp contrast to the history of being a 'one tranche' country. Foreign exchange reserves on June 2016 stood at the healthy level of \$ 18.1 billion, enough to provide import cover for almost four months. The year, 2015-16, had closed with a remarkably low current account deficit of only \$2.5 billion and a fiscal deficit of 4.6 percent of the GDP, the lowest since 2006-07.

The Staff Mission of the IMF in its last (the twelfth) Review of October of 2016 effectively declared 'victory'. The Staff Report said:

'Pakistan's Fund-supported programme has helped the country restore macroeconomic stability, reduce vulnerabilities and make progress in tackling key structural challenges. Economic growth has gradually increased and inflation has declined. External buffers have been bolstered, financial sector resilience has been reinforced, and the fiscal deficit has been reduced, while social safety nets have been strengthened'

This was an unambiguous statement that on the completion of the EFF Pakistan had entered the path of high, stable, sustainable and inclusive growth.

Not only was the language very positive but also the projections for 2016-17 and 2017-18 promised high growth and very small deficits, both in public finances and in the current account of the balance of payments. The GDP growth rate was expected to exceed 5 percent after a gap of nine years. The fiscal deficit and the current account deficits were anticipated to remain below 4 percent of the GDP and 2.5 percent of the GDP respectively. This, no doubt, contributed to a degree of complacency in the Ministry of Finance.

Given the declaration of success, what went so fundamentally wrong so soon in 2016-17? First, the Executive Board of the IMF was very generous in granting as many as 15 performance waivers during the tenure of the Program. There was apparently a 'compact' whereby only gentle monitoring was expected. Consequently, the commitment to reform may not have been so strong on both sides.

Second, some underlying structural problems of the economy, which needed to be focused on were ignored. The now most commonly referred to unaddressed problem has been the fall in exports since 2013-14 due to an appreciating value of the Rupee.

Third, there were also other deficiencies. The budgetary position was artificially bolstered by some 'creative accounting'. This included the undertaking of large off-budget transactions, reporting privatization receipts as revenues and not as a source of financing, retaining earmarked revenues in the Federal Consolidated Fund, reporting large statistical discrepancies, holding back large tax refunds due, collecting taxes in advance towards the end of a fiscal year, forcing Provincial Governments to generate cash surpluses by holding back releases and so on. The Finance Team on the Pakistani side skillfully pulled wool over the eyes of the somewhat naïve IMF team.

Fourth, the international recession led to extraordinarily low oil prices. The price per barrel of oil fell below \$40 in 2014-15. This reduced the pressure on the current account. The oil import bill remained very low. Further, there were large 'windfall gains' in tax revenues. The sales tax rates on petroleum products were raised to unprecedentedly high levels.

The favourable international environment has changed since and till recently the oil price had jumped to almost \$72 per barrel. Consequently, the oil import bill has risen exponentially in the last two years. The sales tax rates on petroleum products have been brought down drastically. There has been no major privatization since 2015-16. The flow of CSF funds has dried up. The Provincial Governments have reasserted their autonomy and stopped generating cash surpluses. The year, 2016-17, also witnessed a big jump in the size of the national PSDP, partly due to larger outlays on CPEC projects.

All these factors have contributed to a big divergence in outcomes from those projected by the IMF at the end of the Program. The current account deficit which was expected to be 2.5 percent of the GDP in 2017-18 actually approached 6 percent of the GDP. Reserves fell to half the level anticipated. The fiscal deficit hit 6.6 percent of the GDP as compared to the expectation that it would remain below 4 percent.

The IMF Mission appears to have learnt some lessons. The reports following Article IV Consultation and more recently the Post-Program Monitoring, (PPM), one and half years only after the EFF, now have a very different language, which borders on being very negative. A choice paragraph from the PPM report is reproduced below:

'The Executive Board underscored the importance of accelerating structural reforms to reinforce macroeconomic stability, raise competitiveness and promote higher and more inclusive growth. They highlighted the need to strengthen the fiscal federalism, monetary and fiscal policy frameworks; further enhance the AML/CFT regime, improve the business climate, strengthen governance, achieve cost recovery in the energy sector and expand social safety nets to protect the most vulnerable.'

This is indeed in sharp contrast to the very positive assessment of the prospects for the economy following the end of the EFF in September 2016.

The scariest projection in the PPM Report is that the cumulative external financing requirement over the three years, 2018-19 to 2020-21, will approach the colossal magnitude of almost \$100 billion. It could be even higher as the projections of the current account deficit are at 4 percent of GDP only.

Where will we get a total of \$100 billion this year and in the next two years? Manna from heaven is unlikely. Hopefully, a large part of the \$200 billion supposedly held in foreign bank accounts will come back to Pakistan. Alternatively, the diaspora will come to our support by transferring much larger funds to Pakistan through official banking channels. Unfortunately, we cannot assume that one or both these outcomes will be realized.

The bottom line is that the two deficits, especially the current account deficit, have to be brought down very sharply in a relatively short span of time. Hopefully, the Authorities and the IMF Staff Mission will engage in a meaningful dialogue on the various short-term steps and the medium run reforms that will be needed to achieve this objective. We look forward to the outcome of negotiations.

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