

The unsuccessful talks

In a surprising development the talks with the visiting IMF Mission have ended without an agreement on a program. This is an unusual outcome. It is hard to find an example in the previous history of country's relations with the Fund where a full-fledged programming mission returns unsuccessfully. There have been many examples where attempts to revive stalled program were not successful. But there is no example where a negotiating mission did not lead to successful conclusion.

What does it mean to have not negotiated a program? What factors could have produced this outcome? What would it mean for the future of Fund negotiations? In this article we would try to address these questions, which are agitating the minds of the reader.

Successful negotiation of a program essentially means that the two parties have agreed to a set of performance criteria (budget deficit, domestic credit expansion, reserves and access to government borrowing from the central bank) and supporting policies that would be helpful not only to achieve the performance criteria but lay the foundation of a sustainable macroeconomic framework, which would promote growth, price stability, employment and poverty reduction. Not winning the program clearly means that the parties have most likely not agreed on the targets to be set under the performance criteria or the policies to be pursued under the program.

Even though the policy negotiations are difficult too, but more frequently, specially when a new program is negotiated, talks fail due to not reaching an agreement on the performance criteria. In all likelihood, the initial fiscal adjustment - reduction in fiscal deficit in the current year - and what contribution therein would come through the tax effort, would have been the reason for not reaching an agreement. This must have been compounded by the demand from the Fund that at least the unfilled gap - from less than full adjustment in gas and electricity prices relative to what was allowed by the regulators - must be provided from the budget. This would mean a significant increase in the baseline estimate of the deficit and hence even the first year adjustment would be challenging.

The share of tax effort toward fiscal adjustment is always a matter of considerable negotiations. Given the efficacy of tax measures in bringing new revenues, the Fund prefers new taxation as opposed to cutting expenditures which it apprehends may come from those areas that need protection, such as social sector expenditures and thus affect the vulnerable groups.

In these pages, a number of times, we have made the point that the underlying deficit in the budget 2018-19 - notwithstanding its ostensible claim of 4.9pc or 5.1pc - was 7.0pc. The Fund would demand at least a 2 percentage points adjustment to bring it down to 5.0 pc. If this is a tall order then clearly the political cost is considered more important than the imperatives of economic management. If the Government has ways to escape such a demand, it may well be justified to forfeit the program and instead focus on doing their own prudent economics. Could this be possible?

This could indeed be possible if sufficient foreign resources are available to tide over the period when a reengagement with the Fund becomes inevitable. It is not clear as yet what kind of support the government has succeeded in mobilizing from the brotherly countries of Saudi Arabia, China and UAE. The Saudis have deposited one third of the Funds with the SBP though exact terms have not be specified. It is also not known when the remaining \$2 billion would arrive, as are the arrangements with respect to deferred payment sales of oil. Details about Chinese and UAE help are not available as yet.

Some analysts have surmised that the hasty conclusion of talks without a positive outcome is due to assurances the PTI leadership has received from these countries about a bail-out package. In our view, this should not be a cause of gratification. If you have to endure pain under a Fund program, how someone else would agree to alleviate it without seeking some compensation, although it may not be fully known to the public. Why should Pakistan take a support of this nature. It doesn't solve our problems. More importantly, such a dependence would

undermine the credibility and competence of the PTI government, as it would be perceived unable to face difficult economic problems it has inherited, and it would be accused of attempting to stay clear of troubles during its time in office. This would be a defeatist approach unworthy of adoption at the outset of a five-year term.

More significantly, the time before the next Fund engagement would most likely add to the challenges of the economy. The new data on the current account for the month of October, and for four months Jul-Oct, shows that the pressure on current account has abated but not sufficiently to steer us out of troubled waters. Based on this data, current account deficit in October was recorded at \$1.2 billion and during July-October it dropped by only 4.6pc relative to last year, though the required decrease is more than forty percent. This means that the economy remains vulnerable to both; external shocks as well as high demand for imports. The palliatives from friendly countries' support would only delay the day of reckoning but not cure the fundamental imbalance.

The fiscal side is the real culprit. With a growth rate of less than 8pc in FBR revenues the fiscal deficit appears to be out of line and the claim of 5.1pc, despite the measures in the mini budget, looks increasingly suspect. Under the circumstances, there is no room for complacency. The government would do well by not wasting time in resuming the dialogue with the Fund. The longer it takes to achieve this aim, the harder it would be to make the required adjustment.

More importantly, the government should take economic stability as more important than political palatability. The view that the government had done enough already, and was not ready to take further actions, should give way to the realization that almost all the required adjustment is due to the failure of the previous government in the last two years and therefore the nation has to endure the cost of clean-up. If it is not done today it would have to be done tomorrow, albeit at a much high cost.

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