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The IMF flip-flop

In yet another flip-flop, Prime Minister Imran Khan stated on October 17 that Pakistan may not have to approach the International Monetary Fund (IMF) for credit as some 'friendly' countries may help ward off the difficult balance of payments (BoP) situation the country finds itself in.

Exactly a week before, his finance minister met the IMF director-general in Bali and requested financial assistance from the multilateral donor. While it is not bad to count on friends and allies, a discordant stance on seeking loan from the Fund will only breed uncertainty, which the country can't afford.

In view of the substantial external capital needs of Pakistan, avoiding going back to the IMF has a remarkably low probability. If the past is any guide, when everyone else turns their back on us, the Washington-based multilateral donor offers the only hope to salvage the economy.

Since the General Ayub regime of the 1960s, there has hardly been any government that did not draw credit from the IMF. Therefore, having petitioned the Fund for economic assistance, the PTI government has only followed in the footsteps of its predecessors. Barring diehard PTI supporters, who were schooled in the beguiling narrative that borrowing abroad runs counter to national honour and that it is better to starve than to beg, and who were naive enough to believe that political leaders should always be taken at their word, few were surprised over the decision.

How we see and interpret the world depends on where we are. When a party is jockeying for power, it regards the 'corrupt' and 'incompetent' people in power as the source of all problems and their exit as the only panacea. By the same token, when Imran Khan was in the opposition, he would repeatedly remark that the economy's dismal performance was underpinned by massive corruption at the top. Now that 'Mr Clean' himself is skippering the ship of the state, it must have dawned upon him that things are not as simple as they appeared from the container.

Rhetoric aside, borrowing from the IMF or, for that matter, from any other source neither amounts to begging nor constitutes an affront to national honour. On the contrary, foreign debt is necessary for bridging the yawning gap between national savings and the desired level of investment – a situation which confronts almost every developing country.

In the modern era, few nations have registered economic development without having to accumulate debt. An economy like Pakistan, with meagre domestic savings, can avoid borrowing only in two ways: one, it attracts substantial foreign savings in the form of investment from abroad; two, it abandons economic development as a policy objective. Since the level of foreign investment has been rather low over the years and the development goal can't be foregone, the result has been debt-accumulation.

At the end of June 2018, Pakistan's total external debt amounted to $95.07 billion as compared with $30.41 billion at the end of June 1998. During the last 20 years, the external debt stock has galloped more than three times. However, when an economy grows, its nominal debt also goes up and so does its capacity to service the debt. A more reliable indicator than the debt stock is the debt-to-GDP ratio. At the end of June 2018, the external debt-to-GDP ratio was 26.6 percent as compared with 48.8 percent in June 1998. This is because the size of the economy has grown from $62.2 billion to $283 billion during this period – by more than 4.5 times.

The present government isn't responsible for the precarious economic predicament. The PTI government inherited external payment deficit worth $18.13 billion (5.7 percent of the GDP) from the PML-N government (2013-18), which was handed over payment deficit worth $2.9 billion (1.1

percent of GDP) by the PPP government (2008-13), which received a deficit worth $14 billion (8.5 percent of the GDP) from the outgoing PML-Q government (2002-08), and so on.

As a rule, the external payment deficit scales down the exchange rate and practically sucks the foreign exchange reserves dry. This happened in 2008 and 2013, and now in 2018. Only hefty foreign capital inflows can pull the economy out of this difficult situation.

In November 2008, Pakistan signed a two-year stand-by arrangement with the IMF for $7.6 billion in assistance, which was later enhanced to $11.3 billion. Then in September 2013, a $6.12 billion loan agreement was inked with the IMF. At present, the government is eyeing credit worth $7.5 billion from the Fund. As in the past, the start of an IMF programme will shore up Pakistan's credit-rating and make it easier to obtain credit from other donors.

The outcome is that one government after the other found the economy in a bad shape, struck a credit agreement with the lender of last resort – which helped stave off the external payment crisis for the time being – and, at the end of its tenure, left the economy in such a shape that another deal with the multilateral donor became a fait accompli. Here we are reminded of a famous line from the poet T E Eliot: "In my beginning is my end".

Since Pakistan's credit requirements are immediate as well as substantial, the PTI government has already made an inordinate delay in approaching the IMF's credit window. Bringing back billions of dollars allegedly stashed away or receiving heaps of foreign exchange from overseas Pakistanis, on which the ruling party was avowedly banking, was always a pipedream. When dreams shatter, the reality, however unpleasant, has to be accepted.

If, perish the thought, the expected help from friends doesn't come through and Pakistan goes to the IMF, the only possible roadblock to another agreement is opposition from the US, which is the single largest contributor to the Fund's kitty. The IMF's head has also stated that the body would examine the level and composition of Pakistan's external debt to assess the country's debt sustainability.

Washington regards the 'huge' Chinese debt incurred in the course of CPEC as the principal cause of Pakistan's BoP problem. However, the PML-N – whose government signed CPEC-related agreements with China in 2015 – doesn't see eye-to-eye with Washington on the ground that the repayment of Chinese credit under CPEC would commence after 2022 and that the annual debt-servicing cost wouldn't exceed $2 billion. The finance minister has also supported the PML-N's position.

Be that as it may, it can't be denied that China is the largest source of Pakistan's imports and the largest contributor to its trade and current account deficits. Meanwhile, Pakistan needs to upgrade its infrastructure and, therefore, has to import great gobs of plant, machinery and other capital equipment.

The view that CPEC underlies Pakistan's BoP crisis is only partly valid. CPEC started in 2015. Between 2012 and 2014, the three years preceding the start of CPEC, Pakistan's imports from China went up 43 percent from $6.7 billion to $9.5 billion. During the last three years (2015-17), when the implementation of CPEC-related projects started, the imports from China rose 40 percent from $11 billion to $15.4 billion. The data shows that Pakistan's imports from China had jumped up even before the mega programme saw the light of the day. At any rate, the deal with the IMF will make the government come clean on the country's CPEC-related obligations.

A country's external sector performance reflects the state of its economy and productivity. Therefore, the government needs to correct the economic fundamentals, so that the country doesn't need to go back to the IMF or any other donor after five years.

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