DAWN

IS IMF AVOIDABLE?

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IT is now generally recognised that we face the herculean task of settling our external obligations. However, what is less widely understood is that the structural factors underlying the massive current account deficit of and the rapidly growing debt repayments have made the present crisis deeper and more protracted in nature (especially with the rising price of oil). In the short-term the external financing gap presents a formidable challenge with the more immediate requirement likely to be $28 billion for the current year.

And the fiscally irresponsible budget for 2018-19 tabled by the outgoing government is expected to worsen both the external and domestic imbalances, thereby queering the pitch for the next government, making its task even more daunting, both economically and politically (the latter may just make the withdrawal of the income tax concessions almost impossible).

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An IMF programme has become unavoidable because no amount of external flows from friendly countries and bonds taken up by our diaspora will be able to meet the financing requirement of $75bn over three years. This die was cast some time ago and while some respite has been provided by the recently acquired Chinese loans, dithering and procrastination in starting discussions with the IMF will weaken our negotiating position with each passing day.

More importantly, even a double-digit IMF assistance (more than our actual entitlement) will be spread over a three-year period. This will result in available resources (including aid from the World Bank and ADB) falling well short of the funds required to settle this year's liabilities, unless the new government undertakes politically unpopular adjustments. These adjustments (briefly highlighted below) are likely to include further depreciation of the rupee, partly because the pressure on the rupee and the foreign exchange reserves is not likely to subside anytime soon following the initiation of 'global currency wars' as one outcome of the trade wars. This revision will address the issue of creeping speculation against the rupee, while improving the competitiveness of our exports.

Next, to maintain reserves at a level that can cover at least two months of imports we will need to curb imports by at least 15 per cent lower (covering items beyond just consumer products). To achieve this objective supplementary measures, like broader application of cash margins and upward revisions in customs duties, will be required, which will admittedly lead to a compression in growth.

Corrective measures would extend to further enhancement of interest rates. The regime of low interest rates even after the 14pc depreciation of the rupee continues to disincentivise savings in rupee-denominated financial instruments that would provide funds for investment (incentive worsened by the withholding tax on banking transactions). Not surprisingly, rupee deposits have grown by only 7pc (just above the interest earned during 2018 on rupee deposits at the beginning of the year July 1, 2107) while the net increase in the National Savings Schemes is actually negative! Admittedly, this measure will also have a dampening effect on growth.

Only by entering into an IMF programme will we be able to ease the pain of correction. The adoption of a Fund programme will not only facilitate the mobilisation of funds from multilaterals but also improve our access to international capital markets (both in terms of tenor and interest rates), thereby enabling a gradual and less painful path for undertaking the long delayed essential external adjustments.

The World Bank and the ADB, however, can at best provide $2bn each. But these funds are contingent upon the availability of a 'certificate of good behaviour'/comfort letter from the IMF, requiring our endorsement of a Fund programme. Moreover, the $4bn from these institutions is not likely to flow into our coffers in full. Their assistance is now essentially in the form of project aid. And going forward we may not have the absorptive capacity to utilise these volumes. In the short-term there will have to be an inevitable sharp pruning of the rupee component of the Public Sector Development Programme (already cluttered with too many schemes) to cut the fiscal deficit to manageable levels, unless the development programme is rationalised — involving a renewed focus on water and energy and the scrapping of schemes at the initial stages of implementation.

One hopes that the slowing down of the growth rate following the squeezing of imports will be less harsh as a consequence of a faster rate of growth of exports and CPEC-related investments accompanied by timely payments of duty drawbacks and tax and GST refunds at the time of export receipts.

The inflationary impact of the measures above can partly be moderated by the utilisation of cheaper sources of energy through an improvement in the fuel mix and by adjusting downward the support and procurement prices of sugar and wheat to reflect the decline in international commodity prices.

Moving onto the issue of the fiscal deficit, the fiscal position of the federal government is highly compromised with limited room for maneuverability (more than 58pc of tax revenues being earmarked for the provinces). Such an outcome has been precipitated by the failure of the federal government to a) right-size itself after the 18th Amendment; b) to pass on any portion of the burden of energy and fertiliser subsidies and BISP allocations to the provinces; c) to stop the steady accumulation in losses of SOEs and its continued financing and execution of vertical programmes and intra-provincial projects.

To summarise the discussion above we are witnessing the brewing of a full-blown fiscal crisis. It should be obvious that the challenges identified above will literally consume the energies of the next government in its first year of office, requiring painful adjustments throughout the currency of its tenure (especially during what is generally referred to as the honeymoon period).

A fear is that the likely Fund programme would again be cluttered with too many performance criteria and targets, several of them covering subjects in which the IMF cannot claim core competence. Ideally, given the IMF's technical capabilities the programme should only cover tax policy and structure, monetary policy and balance of payments. Regrettably, despite its acknowledged know-how of tax systems, the IMF has been guilty of supporting, on its watch, the development of a complex and dysfunctional tax regime and a cumbersome management system, resulting, for example, in a structure of almost 70 different types of withholding taxes and a legal category 'non-filer', thereby failing badly to induce fundamental sustainable reforms in the area of its expertise.

This article has deliberately chosen to remain silent on whether the IMF can be bludgeoned into translating the threat of the US Secretary of State into actual actions. It is not obvious how the Fund will be able to ring fence its assistance to prevent its utilisation to settle our Chinese liabilities, if the latter choose nether to reschedule their loans nor accept settlement through transfer of Pakistani assets.

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