

### **‘Tough’ IMF programme**

According to media reports, the Ministry of Finance (MoF) officials have had a recent video conference with members of the IMF Staff Mission in Washington. This indicates that the lines of communication are still open and Pakistan is continuing to explore the option for signing on to an Extended Fund Facility (EFF) with the IMF of a currently unspecified amount.

Meanwhile, domestically there continue to be contradictory messages about seeking IMF support or not. The Finance Minister has said on various occasions that a 'tough' Fund Programme will not be acceptable. Apparently, the Prime Minister has strong ideological reasons for not approaching the IMF and has asked for a Plan B to be put together with no financing from the Fund and reliance mostly on support from friendly countries.

The consequence is that there is considerable uncertainty about the short-run prospects for the economy. There is even talk of change in the economic team due to policy differences. This possibility has arisen after the unprecedented 'spike' in the exchange rate on Monday, the 3rd of December. The growing uncertainty about the stance of the Government has led to a plummeting of the Share Price Index last week of 1934 points and a consequential loss in market capitalization of over Rs 470 billion. Following a probably managed recovery, the Rupee continues to slide down gradually on a daily basis.

A point has been reached where, once and for all, the Government has to convey a clear message to the markets. If it is going to the IMF then how 'tough' a set of prior actions will be acceptable? Alternatively, if a deal has been struck with friendly countries then what is the overall magnitude of funding that will become available to meet the short-run financing requirements at least up-till end-June 2019?

There is no doubt that the situation of the balance of payments and the level of foreign exchange reserves are becoming critical. During the month of November, there was little change in the level of reserves despite the deposit by Saudi Arabia of \$1 billion with the SBP. This implies that the underlying balance of payments deficit in the month was as large as \$1 billion.

The magnitude of 'swap' funds and deposits from a number of sources now adds up to \$4.7 billion. This helps in raising the level of reserves but cannot be used to finance international transactions. The latest reported level of reserves with the SBP is \$7.5 billion on the 30th of November. The liquid reserves are \$2.8 billion, equal to the difference between \$7.5 billion and \$4.7 billion.

This leads to a number of basic questions: How much support will be required from friendly countries if there is to be no resort to the IMF? Alternatively, to what extent should the Government be willing to go in accepting 'tough' conditions/prior actions in the Fund programme?

The answer to the first question requires estimation of the likely current account deficit on a monthly basis from December 2018 to June 2019, till the end of the current financial year. Given the observed trends in the balance of payments over the last five months, the projected current account deficit monthly over the next seven months of 2018-19 is \$1.4 billion. This builds in the impact of some reduction in the international price of oil.

The first major contribution to meeting this requirement is the deferred payment for oil imports by Saudi Arabia. This will be about \$450 million monthly. The potential deposit with the SBP of \$3 billion by Saudi Arabia cannot be used to finance international transactions. Foreign direct investment of approximately \$200 million monthly should continue. The multilaterals like the ADB and the World Bank have effectively stopped funding to Pakistan currently. Short-term financing from IDB could continue at an average of \$200

million monthly. China and other bilateral donors are likely to continue funding of another \$200 million monthly, especially by China for CPEC projects. Commercial borrowing of up to \$200 million on average may also be forthcoming. Finally, the private sector is likely to maintain its borrowing monthly at approximately at \$150 million. Consequently, the total gross financing that should become available under present arrangements is \$1.4 billion monthly.

The monthly external debt repayment is estimated at \$ 1.1 billion from December 2018 to June 2019 .Therefore, the monthly net inflow into the financial account of the balance of payments is estimated at \$300 million over the seven months. As such, if reliance is to be placed only on financing only from friendly countries then the total requirement of loans or deferred payment facility on imports to fully finance the projected current deficit of \$ 1.4 billion monthly is \$1.1 billion. Therefore, the total financing required in the form of loans or deferred payment facility from friendly countries from December 2018 to June 2019 is \$7.7 billion, excluding deposits by these countries with the SBP.

The government is reluctant to reveal the total funding that will be forthcoming. Therefore, there is need to focus on IMF not only for meeting the residual requirement directly through the EFF but also from other sources which will be willing to extend loans to Pakistan in the presence of a letter of comfort from the Fund. This will, of course, require that reserves are raised to \$11 billion to provide import cover of at least two months.

Turning to how 'tough' the IMF prior actions/conditions can be to become acceptable to the MoF, there is need to look at the last two programmes of Pakistan with the IMF. The first was the Structural Adjustment Facility (SAF) of 2008 and the second the Extended Fund Facility (EFF) of 2013.

The SAF was negotiated by a newly-inducted PPP government after the massive 'oil price shock' of 2007-08 which raised the current account deficit of 2007-08 to an all-time high of 8.3 percent of the GDP and led to a severe depletion of reserves to only \$4 billion by end-October 2008.

A set of severe conditions was imposed by the IMF. The Rupee had to be devalued by 32 percent. The tax revenue target of FBR for 2008-09 required a growth rate of 25 percent. The PSDP was brought down by 29 percent in real terms. Given the relatively high inflation rate, the SBP policy rate was raised to 15 percent. Electricity tariffs in 2008-09 were enhanced by almost 30 percent. A big Petroleum Levy was introduced yielding revenues of 0.6 percent of the GDP. A major tax reform involving the development of an integrated national VAT on goods and services was agreed to. This finally became the stumbling block and led to a premature end of the Programme.

The 2013 programme was motivated more by the pending liabilities of repayment of the remaining \$4.5 billion to the IMF of the amount released under the SAF and the presence of meager reserves of only \$5 billion. However, the underlying current account deficit was relatively small at only 1 percent of the GDP. Nevertheless, the MOF agreed to a depreciation of 10 percent in the value of the Rupee during 2013-14. As a prior action, electricity tariffs were raised by 30 percent so as to bring down the tariff differential subsidy by almost 20 percent. FBR revenues were required to show a growth of 25 percent in 2013-14 and the fiscal deficit was to be brought down sharply by 2.5 percent of the GDP in the first year of the Programme.

Therefore, there has been the tradition of tough prior actions/conditions in Fund programmes with Pakistan over the last decade, especially on the fiscal and monetary policy fronts and in key areas like privatization and the power sector. Given the extremely large external financing requirements of almost 10 percent of the GDP in 2018-19, there is clearly a need for a strong process of adjustment to stabilize the economy and sharply reduce the future financing requirements.

Given the precedent of apparently tough IMF programmes, there is need for the government to continue negotiations with the IMF, but with the realization that strong policy actions are required to take the economy back to a stable and sustainable path after the very large deficits left behind by the previous government.

As a concerned citizen of Pakistan, I make the appeal for more clarity and a stronger sense of direction from the Government. If the amount required to meet the financing gap of almost \$7.7 billion from friendly countries has been arranged for then this will provide for smooth sailing on the economic front without painful measures. But the question remains as to what will happen after this year. Will our friends come to our rescue once again in 2019-20 and thereafter? As opposed to this, the Fund Programme can provide breathing space for up to three years while critical reforms are implemented such that hopefully we need no more Fund programmes in future. A clear announcement by the government on the path to be taken to stabilize the economy will contribute greatly to removing uncertainty in the markets.

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