

Readying for the IMF

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Islamabad economic machinery has seriously started working on structure of a possible IMF programme. The modus operand of pre-programme negotiations are usually that ministry of finance, SBP and other stakeholders prepare list of reforms, propose fiscal goals and set external limits for the IMF to make it part of the programme.

The technocrats and bureaucrats normally try to include conditions where political will and consensus lacks. But history suggests that despite stiff conditions, reforms remained elusive. Thus, the process is required to come up with practical, implemental and focused reforms agenda.

Back in early 2000s when nominal economic growth was higher than public debt accumulation, there was hope that the country is exiting the IMF for good. But the party was short lived, and the IMF has been a permanent feature ever since.

In the last two democratic regimes, expansionary fiscal policies and deteriorating public institutions resulted in losses in public sector entities and higher subsidies in energy sector. Growth of public debt surpassed nominal GDP growth and that has led the economy to an unsustainable path.

The core of economic problem is in fiscal slippages. Lately, the focus has remained on revenue generation with nothing much on curtailing administrative and inefficient expenditures. All the fiscal austerity is attained by slashing development expenditure.

This is not the right recipe. The key to the fiscal discipline is to cut down administrative expense and the most important reform is to strengthen public entities and institutions.

The SBP monetary policy and SBP documents in the times of the caretaker finance Minister Shamshad Akhtar, used to emphasize on fiscal reforms. The practice slowly died down and now from SBP's policies narrative it appears that fiscal house is just doing fine.

The first step is to correct a fundamental issue emanated after 7th NFC award – Pakistan's current fiscal model is unique where federating units are generating cash surpluses while the federal government is close to bankruptcy. The solution should not be to undo the higher share of provinces from federal divisible pool. Rather, the responsibilities of expenditures have to be passed on to provinces.

The federal government should do away with energy sector subsidies. The energy mess is required to be fixed. Gas prices ought to be increased as differential margin recoverable from SNGP is increasing at Rs6 -7 per month for serving around one fourth of gas consumers. The amount will eventually be recovered from federal government kitty.

Similarly, power sector circular debt is growing and has to be cleared soon. The problem of theft and recovery has not improved in the past few years. Why does the federal government pay for losses which are high in some geography? The losses or subsidies should be moved to provinces, if not to cities.

The whole idea is to redo the fiscal framework. Fiscal austerity should not be achieved by cutting down development; but by cutting federal subsidies, lowering PSEs' fiscal burden and removing duplication of functions. The appointments of heads in PSEs and economic institutions should be on merit and there should be no headless organization.

The idea is to shrink public sector footprint and let the policies work on expanding private sector financing. In the last few years, Dar's policies fetched some tax revenues at the cost of higher cost of doing business which is resulting in higher informality.

Had the currency in circulation to M2 and Prize bond to NSS ratios not changed after the imposition of WHT on non-filers, the system money could have been higher by around one trillion rupees. This is the size of a big bank; the country could metaphorically generate another MCB bank by enticing the cash back in the formal economy.

The efforts should be to bring that money back into the system and incentivize banks to lend that to private sector. With a multiplier effect, this can add Rs2.5 trillion to the formal economy or increase it by 7 percent.

The interim set up in for a mere seven weeks, Shamshad and team should set the policy tone by doing ground work for negotiation with the IMF. The immediate need is to do demand management which may fall in the ambit of the interim set up. The prescription is simple - monetary policy is required to be tightened, 25-50 bps is not enough seeing the precarious balance of payment situation. A big emergency hike might be in offing.

In case of exchange rate, currency should not depreciate more than 3-5 percent as the REER is at 111 in Apr and it may come down a bit to 107-109 by May. Another 3-5 percent devaluation, may bring REER to around 103-105 levels which would be close to equilibrium to let the market adjust itself.