



IMF Partnership and Pakistan's Economic Future

Since the conclusion of World War II, the International Monetary Fund (IMF) has wielded significant influence over the global economy. Established on December 27, 1945, with headquarters in Washington, D.C., the IMF boasts 190 member countries and serves as a lender of last resort to national governments. Its pivotal role extends to maintaining exchange-rate stability and fostering global monetary cooperation. The IMF's overarching mission includes ensuring financial stability, facilitating international trade, promoting robust employment, sustainable economic growth, and alleviating poverty worldwide.

Pakistan's economic journey has been closely intertwined with the IMF. Throughout its history, the IMF has played a crucial role in extending financial assistance and providing policy guidance to Pakistan amid challenging economic circumstances. Since its inception, Pakistan has repeatedly sought IMF support to navigate various economic challenges, resulting in the country benefiting from 23 IMF loan programs. However, these interventions have not been devoid of controversy, often accompanied by stringent conditions with far-reaching implications for Pakistan's economy and society. The economic landscape in Pakistan has encountered significant headwinds, resulting from a confluence of factors such as in below table:

The policy implementation during the 2019–23 Extended Fund Facility (EFF) in Pakistan faced significant hurdles, resulting in missed opportunities and potential costs for the economy. Let's delve into the key aspects:

1) Comprehensive Framework and Missed Opportunities:

- The EFF aimed to create a robust foundation for Pakistan's economy by strengthening fiscal and external sustainability.
- Structural and institutional reforms were crucial for fostering balanced growth.
- Unfortunately, incomplete and uneven policy execution hindered progress.



Muhammad Azam, ACMA
General Manager
[Finance & Accounts]
Al-Haj Automotive (Pvt) Ltd.

2) Early Progress and Subsequent Setbacks:

- Initially, there was encouraging progress, including fiscal adjustments and transitioning to a flexible exchange rate system.
- The establishment of a modern and independent central bank was a positive step.
- However, these gains were not sustained over time.

Factors	Outcomes
Ongoing Crisis and 2022 Floods	• Economic activity has slowed considerably, partly due to the ongoing crisis. • The devastating 2022 floods caused widespread damage and disrupted livelihoods.
External Financing Constraints	• Tightening external financing conditions have added strain to Pakistan's economic stability. • International reserves, currently standing at approximately ¾ month of imports (equivalent to US\$4.2 billion), reflect the severity of the situation.
Inflation Surge	• Inflation has surged to a record high of 38 percent as of May 2023. • Rapid price increases reduced the purchasing power of citizens and posed challenges for policymakers.
Fiscal Pressures and Debt Sustainability	• The floods, coupled with policy slippages, have intensified fiscal pressures. • Debt sustainability is at risk, necessitating prudent financial management.
Social Discontent and Eroded Living Standards	• Social discontent has risen due to deteriorating economic conditions. • Living standards have eroded, impacting the well-being of citizens.
Escalating Political Tensions	• In May, political tensions reached a critical point. • Growing political and institutional divisions are making the economic situation more complicated.

3) Unprecedented Shocks and Eroded Commitment:

- COVID-19 pandemic in 2020 and devastating floods in 2022 disrupted economic growth.
- Inflation surged, exacerbating social pressures.
- Pressure from vested interests complicated policy adherence.

4) Energy Sector Challenges and Exchange Rate Interventions:

- Deep-rooted issues in the energy sector remained unresolved.
- Pursuing expansionary policies for rapid growth had unintended consequences.
- Foreign exchange interventions to stabilize the exchange rate proved challenging.

In hindsight, addressing these complexities requires a holistic approach, long-term commitment, and adaptive policy measures.

The fiscal effort outlined in the FY24 budget represents a crucial stride toward ensuring fiscal sustainability. However, it must be complemented by further reforms. The consolidation proposed in the FY24 budget is appropriate, and it is reinforced by measures aimed at enhancing revenue mobilization and curbing non-priority expenditures while safeguarding social assistance. To mitigate significant risks related to macroeconomic stability and fiscal sustainability, strict budget execution is imperative. This entails restraint on current spending and vigorous efforts to boost revenue collection through enhanced tax administration.

Looking beyond FY24, the focus should remain on developing a more progressive, streamlined, efficient, and equitable tax system. Such a system would create ample room for critical development initiatives and social spending, including measures to strengthen resilience against climate shocks. Improved public financial management is pivotal in maximizing the efficiency of our limited resources

Challenges and Reforms

- Pakistan grapples with persistent challenges such as fiscal deficits, external debt, inflation, and low foreign exchange reserves.
- IMF programs come with conditions, necessitating reforms in areas like taxation, energy, and public sector enterprises.
- Implementing these reforms is crucial for Pakistan's economic stability and progress.
- Navigating these challenges requires concerted efforts, sound policies, and a commitment to sustainable development.

Steps to be taken for Pakistan's Future Growth

a) Poverty Reduction and Social Protection

To significantly reduce poverty and strengthen social protection, increased focus and investment in social spending are necessary. The IMF has commended the enhancements made to the Benazir Income Support Program (BISP), including expanding its reach to more beneficiaries and adjusting benefit levels for inflation. However, the IMF emphasizes the ongoing need to improve the generosity of BISP stipends and ensure that all deserving families are enrolled in Conditional Cash Transfer (CCT) schemes.

b) Inflation Control

The IMF has strongly criticized the State Bank of Pakistan (SBP) for its management of inflationary pressures. According to the IMF, the SBP's monetary policy has lagged, not reacting promptly to the increasing inflation from 2020 onwards. The IMF staff report emphasizes several important points:

- **Tightening Monetary Policy:** IMF emphasizes that monetary policy should remain tight, proactive, and data-driven. While the recent policy rate hike is a positive step, the tightening cycle should continue if necessary to combat inflation and support external rebalancing.
- **Real Policy Rate:** In the short term, the forward-looking real policy rate needs to return to positive territory. This measure aims to re-anchor expectations and achieve the SBP's inflation objective over the medium term.
- **Refinancing Schemes:** Implementing the plan to phase out refinancing schemes will enhance monetary policy traction and bring transparency to these programs.
- **SBP Independence:** The IMF underscores the importance of strengthening and protecting the independence of the SBP.

A tighter monetary policy stance is critical for reducing inflation, anchoring expectations, and supporting external sector rebalancing. While the recent rate hike is welcome, continued vigilance is necessary given the persistence of inflationary pressures.

c) Market determined Exchange Rate

To withstand external shocks, uphold competitiveness, and replenish international reserves, it's vital to let the exchange rate be determined by the market. This strategy encourages inflows and promotes stability. Moreover, it's essential to restore foreign exchange (FX) liquidity by allowing unrestricted price signals. To accomplish this, it's crucial to avoid informal interventions in the market, such as influencing import management and LC approval guidance. These measures are necessary to regain public confidence in the exchange rate system. Additionally, implementing suitable monetary and fiscal policies along with robust reforms will bolster trust in the rupee and tackle external imbalances.

d) Maintaining Financial Stability

Ensuring financial stability requires careful monitoring and quick responses to address undercapitalized financial institutions. The State Bank of Pakistan (SBP) should speed up the recapitalization process using its current authority. Furthermore, it's essential to prioritize the improvement of bank resolution and crisis management frameworks.

The discussion in the cabinet regarding a draft law should be accelerated for further legislative progress. Notably, the SBP must fully utilize its institutional autonomy, which was recently granted under the amended SBP Act, as it forms the bedrock of its independence and mandate.

Pakistan's successful removal from the Financial Action Task Force (FATF) list is a positive development. However, efforts to mitigate Money Laundering (ML) and Terrorist Financing (TF) risks, including those arising from tax evasion, corruption, and other financial crimes, must be sustained.

e) Restoring the viability of Energy Sector

Taking decisive action is crucial to restore the viability of Pakistan's energy sector. The financial health of the power and gas sectors must be prioritized to prevent unsustainable spillovers affecting the national budget, financial institutions, and the real economy. Recent energy measures, including the full surcharge hike and targeted subsidies for vulnerable populations, should be sustained as an initial step in managing these spillovers. To achieve this, several key steps are essential:

- a) Timely Tariff Alignment:** Ensuring that energy tariffs align with actual cost structures, as determined by NEPRA (National Electric Power Regulatory Authority) and OGRA (Oil and Gas Regulatory Authority), is critical. While doing so, it's essential to protect vulnerable segments of the population.
- b) Operational and Financial Reforms:** Implementing reforms to reduce operational, generation, and capacity development (CD) related costs is necessary. These reforms should align with the current power and emerging gas Comprehensive Development and Management Plan (CDMP) to gradually lower tariffs.

f) Structural Reforms:

To lay the foundation for robust, resilient, and inclusive growth, Pakistan must make tangible progress in the following areas:

- **State-Owned Enterprises (SOE) Governance:** Enhancing transparency, efficiency, and accountability within SOEs.
- **Anti-Corruption Institutions:** Strengthening anti-corruption mechanisms to promote clean practices.
- **Business Environment and Investment Climate:** Creating a conducive environment for business and attracting investments.
- **Climate Change Adaptation:** Addressing climate-related challenges to ensure sustainable development.

By addressing these priorities, Pakistan can pave the way for a stronger, more prosperous future that benefits all its citizens.

Economic Risks for Pakistan

The risks associated with Pakistan's economic situation are exceptionally high and predominantly tilted to the downside. These risks emanate from both domestic and external factors. Let's delve into the specifics:

- 1. External Headwinds:** The global financial conditions remain tight, and there are lingering effects of the war in Ukraine, which have led to elevated food and fuel prices. These external challenges pose significant hurdles for Pakistan's economic stability.
- 2. Sociopolitical Climate:** The difficult sociopolitical climate within Pakistan is characterized by persistent political volatility. This instability poses a key risk to effective policy implementation, potentially hindering the country's adjustment path and growth prospects.
- 3. Advanced Economy Financial Tightening:** The tightening of financial conditions in advanced economies could have spillover effects on Pakistan. Geopolitical tensions further exacerbate the situation, impacting the availability of external financing.
- 4. Debt Sustainability:** The materialization of these downside risks could push Pakistan toward an unsustainable debt situation. This precarious scenario necessitates close monitoring, supportive technical assistance (TA), and financing assurances from key lenders.

Despite these challenges, the IMF supports Pakistan's request for a 9-month Stand-By Arrangement (SBA) with access equivalent to SDR 2,250 million (approximately 111 percent of quota). Additionally, the approval of the exchange restriction and the Market-Based Currency Policy (MCP) is recommended. These measures are temporary, non-discriminatory, and implemented for balance of payments (BOP) reasons.

In summary, Pakistan's ongoing partnership with the IMF remains critical for addressing economic challenges and ensuring stability. Striking a balance between immediate adjustments and long-term structural reforms is essential for sustainable development.

References:

1. imf.org/en/News/Articles/2024/01/11/pr2406-pak-imf-exec-board-completes-first-review-of-the-stand-by-arrangement
2. IMF Country Report No. 23/260 – July 2023

About the Author: Mr. Muhammad Azam, an Associate member of ICMA and a Chartered Management Accountant, holds the position of General Manager [Finance & Accounts] at Al-Haj Automotive (Pvt) Limited. With more than 20 years of expertise in Finance & Accounts, he specializes in process optimization and automation, focusing on manufacturing industries, and possesses a profound comprehension of process integration.