

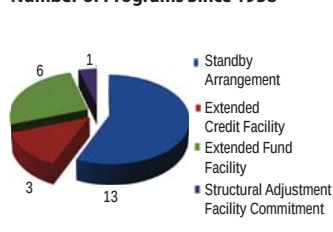


Pakistan under IMF Program: In Search of a Sustainable Solution

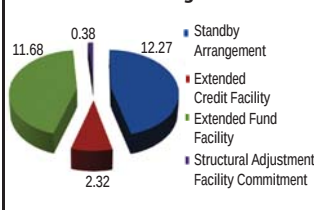
Pakistan's ties with the IMF began with a US\$25 million standby arrangement in 1958, but over time, frequent engagements became a routine course of action. In almost two decades following the first IMF program, Pakistan participated in eight such programs, out of which seven were standby arrangements. The 8th program, the first extended fund facility in 1980, amounted to US\$1.2 billion. In the subsequent two decades, there were ten such programs, while in the last 24 years, there have been five such engagements.

IMF and Pakistan: 1958-2024

Number of Programs Since 1958



Total Amount Agreed Under Different Programs



Data Source: IMF official data related to the history of lending commitments as of 29 Feb 2020

*Details of the last program finalized in 2023 are added to the available dataset

These programs were primarily intended to address the short- and medium-term balance of payment issues. The standby arrangement has been the predominant program in terms of frequency and the agreed amount. While engagements are waning in number, their effects on the country's macroeconomic conditions are waxing over time. In the last two programs, something different was done that was not done in any previous programs.

Most of the parameters laid down in the recent extended fund facility (EFF) of July 2019 were largely implemented rigorously, which has deep-rooted implications for short and medium-term macroeconomic stability. These provisions included a sharp increase in the policy rate, an adaptation of a market-based exchange rate regime, and amendments to the SBP Act (1956) to enhance the central bank's autonomy in its functions and operations. While similar recommendations had been proposed in the previous programs, the way these were implemented in the last two programs is unprecedented. As a result, Pakistan started a journey to achieve the established targets in a way, that every step closer to the established

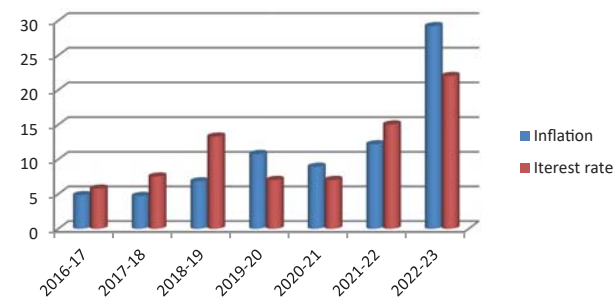
targets makes macroeconomic stability's core objective increasingly challenging.

In compliance with the conditions, the policy rate nearly doubled in 2019, followed by a significant depreciation in the rupee; however, the implications of these actions remained unnoticed due to the pandemic, which led to



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Inflation and Policy rate

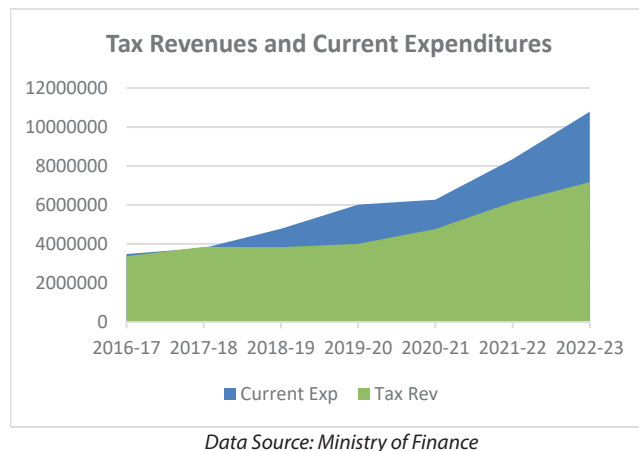


Data Source: State Bank of Pakistan and Ministry of Finance

a substantial reduction in global and national interest rates along with a sharp decline in international trade. When economic activities started to restore to the pre COVID-19 levels, the policy and exchange rates both started converging towards the IMF-targeted levels determined by the IMF and the foreign exchange markets, respectively.

Consequently, inflation started to increase, primarily driven by supply-side factors such as currency depreciation, higher borrowing costs, reduction in subsidies, and increase in tax rates. In the meantime, the SBP Act (1956) was amended per IMF directives. The situation documented in various monetary policy statements implies that the rising energy prices have an impact on CPI and it is impending the efforts to bring inflation down.

This becomes more challenging because of the necessity to address inflation before considering monetary easing. Even though these policy documents present inflation as affected mainly by supply-side factors, the same is handled through demand management policies. The same set of guidelines has severe implications for fiscal stability, as presented in the following figure.



Over the past five years, current expenditure has consistently represented approximately 85 percent of the total federal government expenditures, a figure that rose to 90 percent in the FY2022-23. That is why it is an important indicator to be compared to federal tax revenues. Besides continuous increases in the Federal government's tax revenues with increasing rates during the past, the disparity between these revenues and current expenditure has been expanding at an even faster pace, which is widening the gap and compelling the authorities to fill the gap through new debts mainly from domestic, commercial banks, given the restriction imposed by the IMF program of 2019 prohibiting direct borrowing from the central bank.

To reduce the rising fiscal deficit, along with securing new loans, various expenditure-reducing measures are

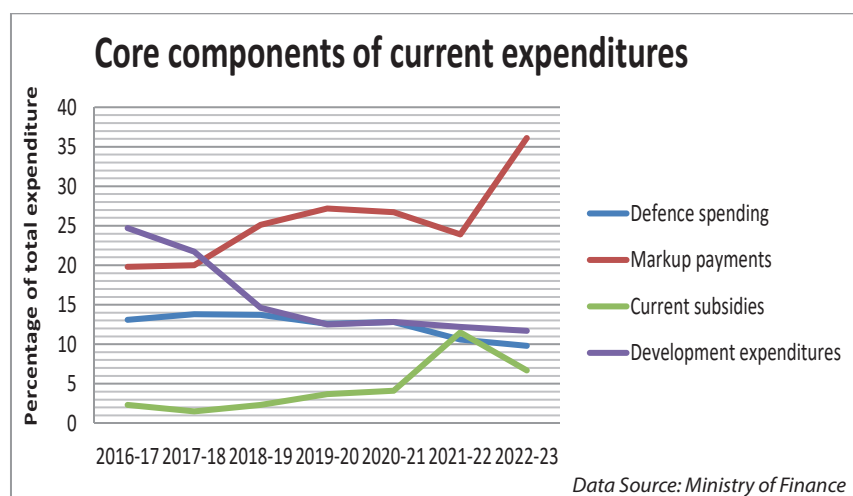
also being considered, including pension reforms, privatization, downsizing, etc. However, none of these are likely to achieve the core objective of reducing the fiscal deficit without addressing the most prominent cause of this rising deficit. The following figure explains the real cause of these fiscal sufferings and some profound implications.

The figure shows that all core components of total expenditures are declining in percentage terms, except interest payments. The significant surge in current spending can be attributed solely to the increase in interest payments. That is why, besides rising federal tax targets every year, the gap is widening even after FBR's remarkable achievements of collecting more taxes than the set targets. These rising tax targets and achievements, coupled with a reduction in current subsidies, are pushing production costs and impeding the decline in inflation. In contrast, without reducing inflation, the policy rate will not reduce. As per a recent official statement from the Ministry of Finance, a 1 percent rise in the policy rate raises the interest payments by around Rs. 600 billion, which means that without a significant reduction in the policy rate, fiscal constraints are not expected to be relaxed.

Simultaneously, these policies hinder export competitiveness and impede export growth, which is the real solution to stable dollar inflows and reduction in the balance of payment deficits, the core objective of all IMF-led reforms.

With the new government having reached a staff-level agreement with the IMF for the final review under the current Standby Arrangement and paving the way for another three-year program, it becomes crucial to re-negotiate subsidy reductions, particularly in the energy and gas sectors. Additionally, it is imperative to urge State Bank of Pakistan (SBP) officials to account for supply-side factors and consider reducing the policy rate

to address the fiscal deficit, production costs, and inflation and promote export growth. Given the low foreign exchange reserves, it is vital to maintain import-restricting policies until specific reserve targets are met. Any agreement reached without addressing the real issues is unlikely to achieve the goal of fiscal stability and avert a balance of payments crisis.



About the Author: Dr. Faisal Sultan Qadri is serving as Research Economist at Applied Economics Research Center, University of Karachi. He expresses his views on economic and geo-political issues at various platforms including national television PTV News.