PAKISTAN'S THREE-QUARTER-LONG MIRACULOUS AVERSION OF DEFAULT

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The IMF has finally indicated that it will be signing the much-awaited staff level agreement with Pakistan. While this must arrest months of speculations about the program and IMF's intentions which were often related to the political economy surrounding Pak-US foreign relations, the agreement is seen by various groups of experts in different lights. One school of thought suggests that Pakistan's elongated era of external account worries is now over and we will see a period of economic stability ahead. The other school thinks that stability will be short-lived and will be in a crisis as soon as the government starts implementing the stringent IMF reform programme. In either case, Pakistan has averted what some economists perceived as an immediate and looming risk – which is the risk of default. However, the tellable tale is not that Pakistan won't be defaulting since that is clear as day now, the tellable tale is why Pakistan didn't default in the last 09 months when its reserves had nosedived to levels where they couldn't support even 15 days of imports and international lenders were not interested in investing given the high risk of commercial debt default.

In one of my pieces for Dawn[1], I attempted to bring home the argument that political instability is bad for the economy – it has both deep and wide-ranging macroeconomic effects. If one comes to think about it, there's a classic contradiction associated with how instability casts its shadow over the economy – the country roars due to chaos and political turmoil while the economy numbs and is thrown into slumber. Pakistan entered into a dampening phase of political instability following the ouster of ex-PM Imran Khan through a vote of no confidence.

A new government was formed that saw Miftah Ismail, a liberal economist with a strong belief in the market, become finance minister. The political turmoil had raised serious concerns regarding an imminent default. Imran Khan was accused of opening doors to excessive spending in his last days at the office which was believed to have led to a steep rise in fiscal and current account deficits that had already begun to show signs of worry since the commodity super cycle started in February of 2022.

[1]Some countries, like the US, even wrote off debt. To gauge how helpful this restructuring exercise was for Pakistan, the debt servicing burden was 41 percent of our dollar earnings in 1998-99 (almost the same as today)

While Miftah was content on leaving the dollar and certain commodities, otherwise strongly regulated by the government, to the market, he was compelled by the prevailing macroeconomic situation to adopt a policy of import controls. Imports were compressed in his first few months at the office which gave a breather to the current account which had become badly suffocated as global inflation continued to tighten its grip over external accounts of Pakistan and several net importing countries. Despite relief on the CAD front, pundits were predicting that the economy will default if the IMF does not complete the 7th and 8th reviews which had become due by then. This was the time when many conspiracies also raised their heads including the surfacing of an audio conversation of an-ex finance minister which was construed as an attempt to derail government's negotiations with the IMF.

Miftah, however, was able to convince the IMF and complete the reviews. Pakistan received a tranche of USD 1.17 billion in September. Miftah was ousted in the same month. While default had been averted, food and energy inflation were on the rise putting excessive pressure on the government which had sworn in on a one-line agenda to control rampant inflation. Miftah was replaced by Ishaq Dar who was enslaved by his own reputation of being an effective manager of the economy. This meant that he had very little time on his hands to turn things around and as inflation mounted and foreign exchange reserves plummeted, pundits were quick to make predictions of a default. I recall, Pakistan's credit default risk which measures probability of default was at 10% while foreign exchange reserves had fallen below USD 4 billion by the end of November of 2022.

Following Sri Lanka's case and default situations in 17 countries including Ghana and Egypt, Pakistan was also pitted as a likely candidate for default. Pakistan didn't default in December, 2022. In fact, not only did it avert default, the finance minister honored all commercial debt and bond repayments due in December of 2022. It continued to avert default even in February, 2023 when the IMF mission arrived in Pakistan. The mission left without signing the staff level agreement (SLA). SLA wasn't signed for a month after they left, following which two months passed and default predictions kept gaining more strength. Then four months passed and came the time of the second budget that this government, which had come with a mandate to take Pakistan to the next elections, had to present. Not only was the budget successfully presented but the government also showed the audacity to present an expansionary budget promising large budgetary incentive to various stakeholders including government servants.

Instead of apologising for predictions that have continued to go wrong, Pakistani economists have now begun to technically knock the public out by saying that compressing imports to balance the external account is like a 'technical default'. This is just a way to smartly alter the reference point and how default is defined and the circumstances that take place if it occurs. A simple way to see if Pakistan got any close to a default is to see if the macro situation that developed in Pakistan was any similar to what happened in Sri Lanka or perhaps the crisis that Venezuela faced as a result of a turf war between its elected and outgoing presidents. Clearly, life in Pakistan wasn't affected at that scale.

Some pundits are also of the opinion that Pakistan's economy was too resilient or too large to default. Looking at Egypt's case, an economy much larger with higher level of imports and external account balances compared to Pakistan, this argument is also flouted. Even though Egypt didn't announce default against commercial debt, it was dangerously close to doing so. Matters there had gotten much worse, especially if compared to the macroeconomic situation that developed in Pakistan. The economy was neither too large nor too resilient to default and the only reason it didn't do so was because it was never actually close to a default.

All the time when reserves had fallen below USD 4 billion and IMF wasn't consenting to come on board, Pakistan was able to balance forex supply and demand through a policy basing its objectives on import compression and expected inflows from friendly countries. And all this while Ishaq Dar and the State Bank were reassuring the public that Pakistan is safe from a default, they were right and the economists were wrong. The economists have been wrong so many times in the past, but the public continues to doubt the politicians instead. Pakistan has a serious capacity deficit when it comes to the planning and management of the economy. Most economists don't have access to information and don't know what the government is doing. While the government must provide transparency, the economists must also attempt to stay in the know and refrain from half-baked and ill-informed analyses.

The author is a public policy professional trained in Economics and International Development Studies with over 10 years' experience in areas of public financial management reforms and macro-fiscal policies and regulations. He has also written quite extensively on the political economy of trade and institutions in South Asia. He can be found on Twitter as @asadaijaz.