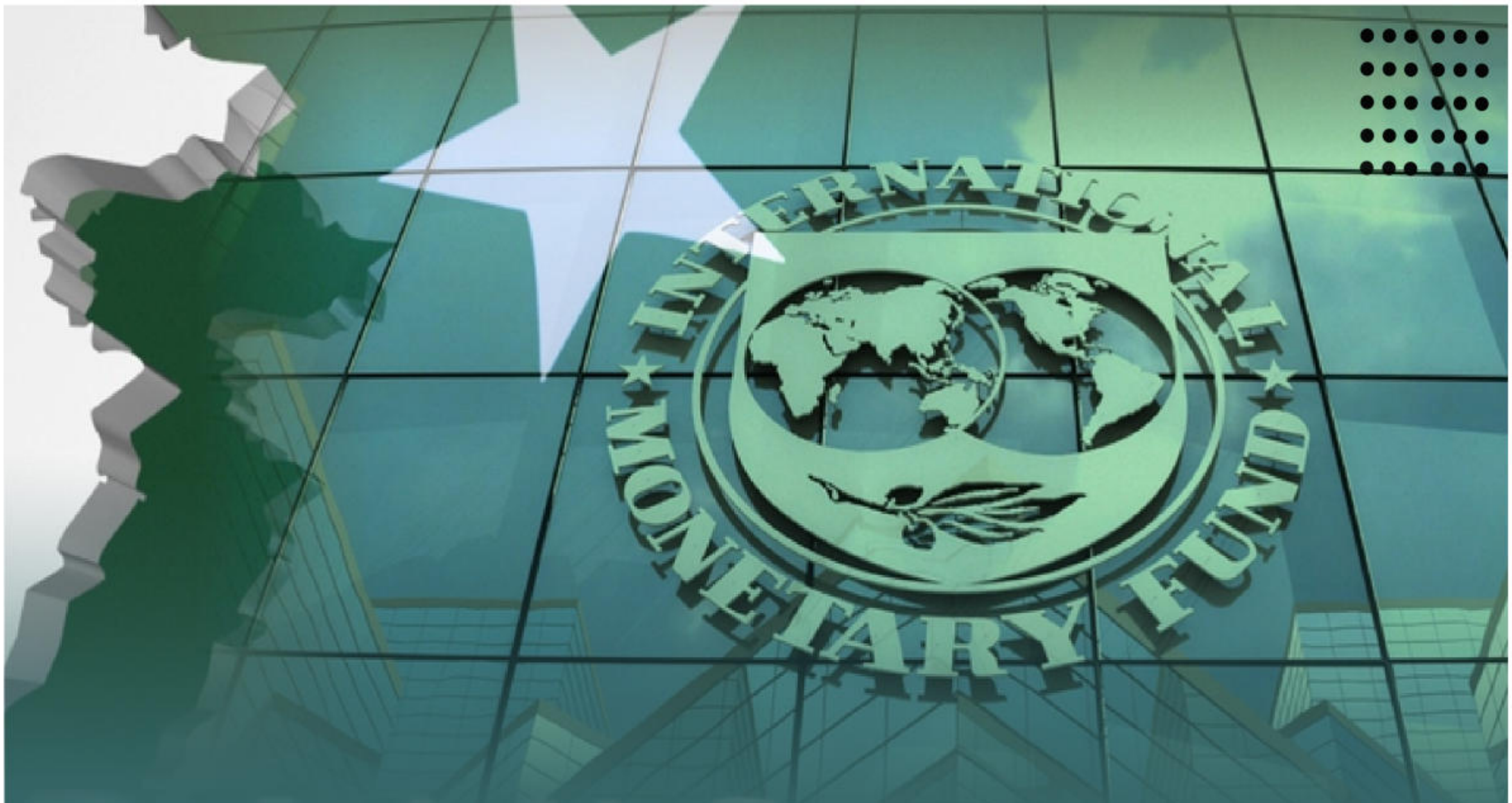

FUTURE OF PAKISTAN ECONOMY WITH THE IMF PROGRAM

Webinar Brief 37:2021

Pakistan Instituteof
Development Economics

Future of Pakistan Economy with the IMF programme

Moderator —
Dr. Nadeem Ul Haque
VC, PIDE

April 08, 2021— Thursday
START 07:00 PM PST

As you are aware that PIDE is engaged academically on a range of topics that covers country's current politico-economic, socio-economic and real economic issues. PIDE believes that public policy research must solve key problems that are impeding progress. To do this, we rely heavily on dialog and debate. PIDE invites inspirational and amazing experts in subjects that we consider central to public policy in Pakistan.
One such key subject of public policy debate is the "Future of Pakistan Economy with the IMF programme". As per news reports Four pending reviews (2nd to 5th) are completed and $500 million for budgetary support will be released very soon. The domestic authorities have adopted some recommendations proposed by the Fund and it is expected that more changes will be made in the coming days. Some favor these tough steps whereas some have vehemently opposed them.

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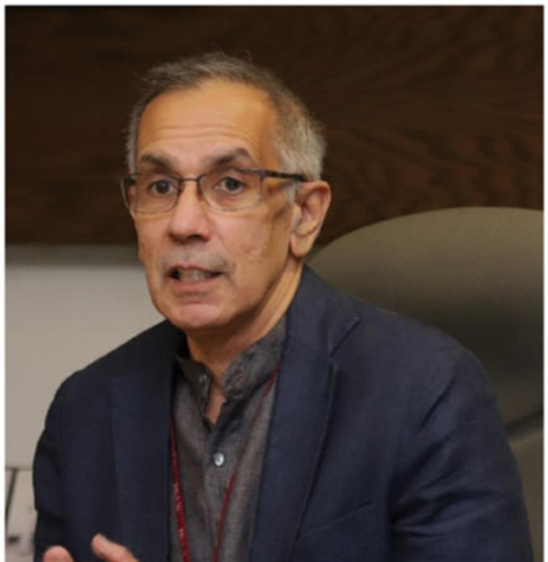
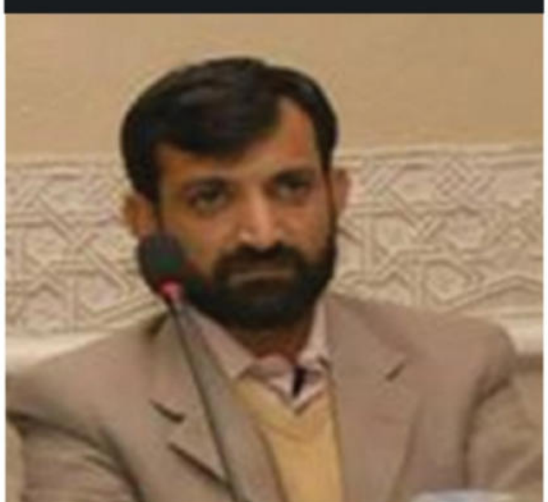


Panelist I—
Prof. Dr. S. Akbar Zaidi
Executive Director, IBA Karachi.



Panelist II —
Prof. Dr. Wasim Shahid Malik
SBP Memorial Chair Professor, University of Peshawar

PART-I

Preamble

This webinar as the title suggests, presents the answer to the questions like

- What is essentially the role of the IMF?
- Where do we see the Pakistan economy is going?
- How would we be performing with the IMF program?
- How do we think we can get out of these IMF programs?

Panelists Dr. Akbar Zaidi and Dr. Waseem shahid shed light on the issue. A healthy debate and intellectual perspective are carved out from the discussion moderated by Dr. Nadeem ul Haque.

Panelist's Key Points

The Viewpoints of Dr. Akbar Zaidi

- Pakistan's economy is on the verge of destruction due to repeatedly pursuing IMF programs.
- We went to the IMF 22 times in 60 years with no sign of a positive impact on the economy and we cannot blame the IMF for this failure, rather it's our politicians and establishment who are responsible for such outcomes.
- Our main problem is the weak taxation system. We do not make efficient use of our resources. Shallow and Incompetent taxation system leads us to the fiscal crisis and ultimately to another IMF program.

The Viewpoints of Dr. Waseem Shahid

- The ultimate goal of the extended fund program is economic sustainability and a laid foundation for balanced growth. The IMF program for Pakistan suggested three-pillar strategies.
  - Effective macroeconomic stabilization through fiscal consolidation and increasing tax revenues
  - Market-determined exchange rate system, price stability, and
  - Social development spending to protect the most vulnerable.
- The problem is related to the governance system and structural reforms of Pakistan.
- In global competitiveness, we have ranked at 110 out of 131 countries, whereas India has 68,Bangladesh has 105, and Sri Lanka has 64.
- The ultimate goal of these IMF programs is highly desirable but there is a severe problem of sequencing and prioritization of goals. In an extreme case, growth or stabilization, none can survive in isolation. There is no growth without stabilization, and stabilization is meaningless without growth. Pakistan's economy lags far behind its contemporary economies like Bangladesh's growth rate is around 7 percent of GDP whereas our growth rate forecast is around 1.3 percent. So even from the growth rate perspective, our economy is deficient.
- Coming to the issue of sequencing, the IMF identified three main problems in our energy sector. First, our tariff rate is low. Secondly, special group subsidies are not shown in the budget. The third problem is related to the generation and the distribution of energy. Taking up the first two problems urgently while secondary importance to generation and the distribution will lead to short-run relief but will be disastrous in the long run.
- Another issue is the conflicting tradeoff in the program's objectives. In the present COVID crisis fiscal consolidation as proposed in the program will add insult to injury. Furthermore, we cannot ignore the impact of the inflation target prescribed by the IMF program on real economic activity. The inflation target suggested is around 5% even in this pandemic crisis which is simply downward biased as these estimates are based on past data.
- Universal Declaration of Human right article 23 is that everyone has the right to be protected against unemployment, but this article is not against inflation. So if we pursue stabilization first and then go for growth then the problem of unemployment would be acute.

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- Lastly, the IMF suggested corrective measures, which seem less than complete. External imbalances which result from our internal sectors deficiencies will again lead to the same situation after every five years. The main loophole here lies in the fact that overvaluation of domestic currency discourages exports. Our remittances, our central bank's intervention in the Foreign exchange markets, and our repeated IMF programs lead to an appreciation of the currency, portraying the partial resolution measures.

Key Messages from the Discussion

- Fiscal consolidation which seems such a logical way out is in reality not just an arithmetic analysis to be carried out in isolation rather one dimension in the multifaceted complex ground realities paradigm. The fiscal side should go side by side with the business activity.
- IMF program or any local solution cannot be fruitful unless there is a will on behalf of rulers to grow, extract the resources efficiently and use them wisely.
- Structural reforms consist of measures to uplift public sectors which need not government involvement in the business activity itself. In its true spirit, it refers to regulatory reforms and addressing institutional hazards which is, unfortunately, the least addressed and ignored aspect in all the programs.
- Regarding the colonial lineage, it is apparent the colonial system cannot be made responsible for our deficiency as there are other countries with the same background but they managed the post-colonial structure very well by their participation without making political noise.

Conclusion

We need to bring the government out of unnecessary involvement in the business activity which could improve the efficiency of the government and thus can strengthen it as a vibrant and capable institution**.** It is not a matter of going to the IMF program rather the will to grow independently. we need to come up with local solutions via local research which can address our challenges effectively so that our future is not destined for IMF programs.

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Distinguished Speaker:

PART II

FUTURE OF PAKISTAN ECONOMY WITH THE IMF PROGRAMME

MODERATOR

NADEEM UL HAQUE
VC, PIDE

19 April 2021

11:00 AM PST

Teresa Daban Sanchez
Resident Representative for Pakistan International Monetary Fund (IMF)

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PART-II

Introduction

The IMF package of measures strikes a balance between supporting the economy, ensuring debt sustainability, and advancing structural reforms while maintaining social cohesion. Amending regulations and improving performance in the gas sector. The IMF program builds on **five pillars**

- Sustaining fiscal discipline anchored on medium-term consolidation while mobilizing revenues and controlling spending to make space for more infrastructure and social spending.
- Ensuring disinflation through an excellent monetary policy stance.
- Preserving the market-determined exchange rate and continuing external rebuilding buffers.
- Restoring the financial viability of the energy sector.
- Advancing structural reforms.

During the election periods, the governments pursue populist policies. In pandemic time, countries around the world are going up with fiscal stimulus, and Pakistan had some stimulus during the first wave, and this third wave is also getting stronger. So, this stimulus needs more packages. The objective of the Program is to provide the road map and guidelines about everything, and these guidelines are the steel valleys.

Moreover, the supported Program aims to help the developing countries that need to stabilize their economy. They also have a structural component of social reforms because the lack of stability comes from deficiencies in the structural dimensions of the economy in the institutions in the policymaking. That is why the standard fund facility has an essential structural component apart from the numbers, targets, and a numeric objective. They want to strengthen the GDP of Pakistan because Pakistan has a tax ratio of around 10% of the GDP, and it has the lowest GDP in the world. It is complicated to run a country of 220 million people with such a low tax ratio. So, it needs to stream the tax ratio.

In the program implementation process, the stability may impact the most vulnerable and experience the actions to restrain the social safety net. The social safety net ensures BISP and EHSAS programs as a comfortable budget envelope and the resources are there. Agenda of the Program to counter all the challenges and problems of Pakistan. Before COVID-19, Pakistan was embarked on implementing the Program with the support of the IMF, as probably approved in July 2019.

The IMF has the first review of the supported Program on December 19 and then works for the second review that was supposed to happen in April 2020. Before COVID-19, the economy was doing well in terms of stabilization. There was an objective to grow at 2.4 but compared to the potential of Pakistan is low. After that, the country was coming to go back to positive growth. Inflation was projected to be in the SBP target zone. The current account deficit was also improving. The primary balance was getting better reserves at the state bank of Pakistan was increasing. There were increasing revenue collections because many reforms were implemented and 80% of GDP, including guarantees. The database was launched to better understand who the beneficiaries are.

We need to be helped. The public finance management law was approved at the same time of the budget in June 2019. The transfer of a single account was launching. There was a circular debt reduction plan to take to tackle the area in the public sector. In April 2020, the economy of Pakistan was contracting. There was a massive concern about the emergence of the external financing needs for Pakistan.

Fiscal (Pillar 1): The Authorities Package

- The primary deficit of the FY2021 budget remains the fiscal anchor with adjusters for COVID-19 related and social spending.
- Revenue collection increase including tax admins, petroleum products, growth, and non-tax revenues.
- Ambitious tax policy reform, including upfront CIT reform to be followed by GST and PIT reforms in the FY2020 budget.
- Reprioritizing spending by the gradual unwinding of the COVID support, rationalizing subsidies, and recalibration of development spending.
- Broad-based fiscal structural reforms, including tax admin, PFM, debt management, and safeguarding the quality and transparency of COVID-related spending, expanding the social safety net.

Monetary (Pillar 2 & 3): The Authorities Package

- Monetary policy continues to be accommodative given considerable slack, constrained fiscal policy, and the absence of BOP pressures. It will be data-driven to anchor inflation within the 5-7 % target over the medium term on a forward-looking basis.
- Phasing out the temporary COVID-19 response measures and maintaining financial sector soundness.
- Commitment to market-based exchange rate, with forex purchases to rebuild reserve buffers amid favorable market conditions, but not to influence exchange rate trends, limit sales to only offset disorderly market conditions.
- Structural reforms including the approval of the amendments to the SBP Act, bolstering AML/CFT effectiveness, fostering financial development and inclusion.

Energy Sector (Power & Gas Pillar 4): The Authorities Package

Long-standing deficiencies and COVID-19 shocks have pushed the energy sector to the edge (e.g., delayed tariff adjustments, deferred payments, temporary COVID-19 related subsidies, and lower demand). Recalibration of the circular debt management plan (CDMP), including the short and midterm measures aimed at reducing circular power debt, such as

- Increasing revenues, aligning power tariffs with cost recovery levels.
- Reducing generation costs, renegotiating with IPPs.
- Streamlining fiscal impact, targeting subsidies, and absorbing PHPL debt, consistently with fiscal sustainability objectives.
- Governance, NEPRA Act amendments, reducing TD losses, recovery, and theft.

Structural Reforms (Pillar 5): The Authorities Package

- Enhancing SOEs' governance, transparency, and efficiency by strengthening the SOE legal, regulatory, and policy framework, triage of the SOE sector, and advancing divestment.
- Boosting the business environment by implementing the approved rational tariff policy and national electric vehicle policy.
- Fostering governance and the control of corruption by strengthening the effectiveness of anti-corruption institutions and enhancing the use of AML tools to support anti-corruption efforts.

Goals of the IMF supported Program

Pakistan remains committed to the goals of the IMF-supported Program. It was approved in July 2019.

- **Firstly**, a revenue-based fiscal sustainability strategy removes exemptions and privileges, enhances social and productive spending, coordinates with provinces, and eliminates quasi-fiscal circular debt and SOE losses.
- **Secondly**, a market-determined and flexible exchange rate, an independent central bank with a primary focus on price stability.
- **Thirdly**, the strengthening of the social safety net, to protect the most vulnerable as needed.
- **Fourthly**, strengthening institutions in the areas: PFM, central bank's autonomy, tax policy and administration, energy sector, SOEs, anti-corruption institutions, FATF, and improving the business climate

Performance on Track Before COVID-19

- In FY2020, growth was projected at 2.4%
- Inflation at 11.8% yet declining towards 5-6%
- CAD at -2.2% of GDP
- Primary balance at -0.8% of GDP
- Reserves at $12.5 billion
- Revenues & Grants at 16% of GDP
- Public debt at 80% of GDP, including guarantees

Solid Policies and Reform Efforts

- Market-determined Exchange rate was adopted with success.
- The tax base was broadened by eliminating privileges adopted (e.g., zero rate regime).
- The safety net was strengthened (e.g., BISP budget increased, a database launched).
- Public Financial Management Law approved, and TSA reforms launched.
- Circular Debt Reduction Plan and NEPRA Act approved by Cabinet.
- Progress with FATF action plan in motion.

COVID-19 Brought a Drastic Change in Policy Priorities

- Growth was projected to decline by -1.5%, and great uncertainty with inflation.
- CAD projected to remain around -2% of GDP, but with lower exports, remittances, lower imports.
- Estimated new external financing needs (US$ 2 billion, 0.8% of GDP).
- Primary deficit increase to (-2.5% of GDP), with revenues & grants to decline to 14% of GDP.
- Public debt (increase 85% to 90% GDP.
- Saving lives and supporting households and businesses.
- Containment measures (e.g., lockdowns), significant impact on economic activity.
- Higher expenditure on health and social safety nets.
- Securing extensive extra funding support.

Strong Fiscal and Monetary Response

- Elimination of import duties and spending for NDMA.
- Daily wagers, Ehsaas cash transfer.
- Exporters' tax refunds and SME financial support.
- Enhanced wheat procurement, utility stores, relief in fuel prices, electricity bill payments deferment, etc.
- Monetary policy support (a 625 bp reduction in policy rate)
- New financing facilities including equipment of hospitals and medical centers, new investment in manufacturing, and avoiding laying offs.
- Relaxation regulations in the financial sector, including the reducing capital conservation buffer, increase the limit on SME credit, reduction debt burden ratio for consumer loans, one-year payment decrement of principal, and relaxed criteria for NPL beyond the 1-year deferment of principal.
- Construction tax packages.

Strong Multilateral and Bilateral Financial Support by Partners

- US$ 1.4 billion under the IMF Rapid Financing Instrument (RFI) by mid-April 2020.
- US$ 250 million mainly by the World Bank's Pandemic Response Effectiveness Project.
- US$ 300 million by the Asian Development Bank (ADB)'s Emergency Assistance Loan, and US$ 500 million from the DB's comprehensive pandemic Response Option.
- The AIIB disbursed US$ 500 million in June 2020.
- DSSI, debt suspensions from May-Dec 2020 for US$ 2 billion by 620 and non-G20 countries.
- DSSI 2, debt suspension extension through June 2021 for US$ 800 billion, by G20 and non-G20 countries.

Current Situation and Economic Outlook and Risks

- **COVID-19:** the 1st wave abated over the summer. The 2nd wave peaked in December 2020 while a 3rd wave is emerging, but still with lower prevalence than peer countries.
- **Growth and Inflation:** negative 0.4% growth in FY2020 yet rebound since the summer, projected at 1.5%. Inflation remains volatile due to food, tariffs, oil, etc., but is projected to decline over the medium term.

- **CAB:** the surplus of 0.4% GDP in the first half of FY2020, low oil prices, import compression, and strong remittances. Reserves grew up to US$ 13.4 billion.
- **Policy Mix:** monetary policy accommodative and fiscal policy prudent. Policy debt with guarantees increased to 92.8% GDP.
- **Risks:** downside, high global uncertainty, policy slippages, implementation capacity, vested interests, oil prices, and tight external financing. On the upside, senate elections and a more assertive presence in the upper house.

Conclusion

The IMF program has now become a stalled program due to COVID-19. The public in Pakistan apprehends that what usually comes with the IMF packages is increasing elective stabilization measures like an increase in tariffs, taxes, fiscal consolidation, etc. The Program aimed at doing that by removing exemptions, removing privileges, and on the expenditure side, enhancing expenditure budget on good social and productive things with much coordination with privacy. This is the strategy of the IMF to ensure sustainability and avoid the boom-bust that Pakistan has been experiencing for the last few decades. The primary focus on the stability of the prices in the country.

The COVID-19 shock temporarily disrupted progress under the EFF. However, the authority's multifaceted policy response has been crucial in mitigating its human and economic impact. This pandemic shock has required a recalibration of policies and reforms. The new package strikes an appropriate balance between supporting the economy, ensuring debt sustainability, and advancing structural reforms. The authorities remain committed to ambitious policy actions and structural reforms to strengthen economic resilience, advance sustainable growth and achieve the EFF's medium-term objectives.

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