**Beyond the IMF deal**

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Pakistan has signed a fresh nine-month stand-by agreement (SBA) with the International Monetary Fund (IMF) worth $3 billion in a last-ditch bid to avoid sovereign default.

The agreement at the staff level is subject to the IMF Executive Board’s approval, which is expected by mid-July. This inflow of funds will undoubtedly help alleviate the country’s dire balance-of-payment issue.

However, this raises fundamental concerns: will this arrangement make people’s lives better and the economy more stable? Do we have adequate policies or procedures in place to avert the ever-evolving financial crises?

As a prerequisite for reaching the deal, Pakistan’s central bank raised interest rates by 100 basis points to 22 per cent on June 26. Several economists believe that raising the policy rate is ineffective at controlling inflation expectations in Pakistan owing to the supply-side rise in prices.

In his book ‘Leading Issues in the Economy of Pakistan’ released in June 2023, renowned economist Hafiz Pasha highlights that the rupee’s depreciation and increasing import costs accounted for 53 per cent of the inflation spike in FY 2022-23. Flood-related supply disruptions and import restrictions contributed a further 27 per cent to inflation.

He also emphasizes that the rising petrol, electricity, and gas prices contributed to 11 per cent of the inflation rate, while monetary expansion accounted for only 9.0 per cent. This indicates that the price hike is primarily attributable to supply-side factors and is unaffected by policy rate changes.

In accordance with the IMF’s conditions, the current government hiked interest rates from 13.75 per cent to 22 per cent for the fiscal year 2022-23, significantly increasing debt service obligations. Interest payments for the preceding fiscal year were initially predicted at Rs3,950 billion; yet by the end of the year, it had soared to Rs5,500 billion.

For the forthcoming fiscal year 2023-24, a sum of Rs7,303 billion has been set aside for interest payments, which accounts for 50 per cent of the federal government expenses. The federal government’s income is insufficient to pay interest.

To secure the IMF accord, the government has levied new taxes of Rs215 billion, primarily on the middle-income salaried class. While the government’s expenditure has been reduced by just Rs85 billion, or 0.6 per cent of the total expenditure to be committed during the current fiscal year. The government has also decided to raise petroleum development levy (PDL) from Rs50 to Rs60 per liter.

The IMF has specifically requested a “timely” rebasing of prices for Pakistan’s electricity sector to ensure that losses are recouped. These policies will aggravate inflation and place more strain on the already oppressed populations.

In a cash-strapped economy, the government’s aim and willingness to implement prudent policy measures are severely inadequate. The tax net/base is confined to certain segments of society. Both the wholesale/retail and agriculture sectors account for 40 per cent of the GDP but contribute only 2.0 per cent of the government tax revenue. While progressive taxation is a viable way of collecting tax money, it has never been prioritized for implementation.

The government has allocated Rs1.074 trillion for subsidies in several sectors. The circular debt of the power sector stood at Rs2.5 trillion at the end of the previous fiscal year, with a whopping Rs300-400 billion added to the debt stock each year. Similarly, circular debt in the gas sector has reached Rs1.5 trillion.

In terms of far-reaching reforms, there has been a cautious approach to privatization decision-making and the adoption of a state-owned enterprise management plan, which has resulted in large income leakages once again. The existing administration has allotted Rs15 billion for privatization earnings, indicating a lack of decision-making on the part of the federal government.

The expenditures of administering civil government have also risen over time, with Rs714 billion set aside for this purpose in the fiscal year 2023-24. The management of majority ministries was transferred to provinces after the 18th Amendment; however, divisions/ departments continue to operate in duplicate. The government must seek ways to decrease costs in the form of protocols, assignment of housing, fuels, and so on.

It is believed that the federal government operates 90,000 cars, which consume around Rs220 billion in gasoline. To set an example for the entire nation, the government should implement austerity measures by slashing such expenditures.

The failure of policy rates in attaining economic stability has substantial implications for the government of Pakistan, which is a major borrower of commercial banks. The vast majority of interest payments are made at a floating rate. Thus, an increase in policy rate entails greater payments for debt servicing.

It is predicted that lowering the policy rate by 1.0 per cent can save around Rs200 billion in interest payments. Hence, to curtail inflation effect, improved governance and market regulation by limiting hoarding, artificial supply shocks and cross-border smuggling might potentially reduce volatility in goods markets and hence give some relief to the desperate people.

Besides these policy considerations, the government lacks direction in attracting remittances and promoting exports. Remittances through banking channels fell to $29.87 billion in 2022-23, down from $32 billion the previous year. Similarly, exports fell to $27.5 billion in 2022-23, compared to $31 billion in 2021-22. The gap between the interbank and open market rates should be narrowed in order to attract remittances through formal banking channels.

Incentives should also be granted to the export sector. The imposition of a windfall levy, a super tax and a withholding tax does not appear to improve exporter confidence. Similarly, no plan is presented in the budget statement to encourage foreign direct investment, which may be a lifeline for the languishing economy.

Pakistan has been in a state of economic turmoil since its creation due to a lack of structural, institutional, and development planning. Famous economists Daron Acemoglu and James A Robinson write in their book ‘Why Nations Fail’ that no amount of donations, aid, or other financial assistance can sustain, let alone reform, a country.

Unless major institutional and structural reforms are implemented, the dependency syndrome in the form of IMF programmes and other multilateral and bilateral assistance cannot be avoided.

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