Pakistan and the IMF : 1988-2002[1]

A case study

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Pakistan entered into nine different agreements with the IMF during the period 1988-2000. Except for the last Stand-by Arrangement (SBA), most other arrangements were not fully implemented and consequently almost half of the agreed amount remained undrawn. The 1990s, however, was a 'lost decade' for Pakistan's economy. During the previous four decades the annual average growth rate was almost 5 percent and the incidence of poverty had declined from 40 percent to 18 percent by the end of 1980s. During the 1990s, growth in per capita income dropped to slightly over 1 percent. Poverty resurfaced and about one third of the population now lives below the poverty line of $ 1 per day. Social indicators are worse than other countries with comparable income. The country has turned from moderately indebted to a heavily indebted country and was also perceived as one of the most corrupt countries in 1996. Institutional decay has been pervasive adversely affecting the implementation and administrative capacity.

Since 2000, however, the SBA was fully implemented without any hiatus and the progress on the Poverty Reduction and Growth Facility (PRGF) approved in 2001 is also on track. The external sector has been secured and macroeconomic stability indicators look good. Growth rate has, however, remained dismal and poverty reduction has not made much headway.

This case study examines the following three questions:

(a) Why did successive governments opt for the IMF programs?

(b) What is different this time? and

(c) What are the lessons for the IMF from this experience?

<u>Why did successive governments opt for the IMF programs?</u>

Pakistan has had nine different governments (Bhutto, Jatoi, Nawaz Sharif, Mazari, Moeen Qureshi, Bhutto, Meraj Khalid, Nawaz Sharif, Musharraf) during 1988-2001. Pakistan entered into nine different kinds of agreements with the IMF during this period. The motivations and intentions of each government may be different but it can be deduced from their actions that there were a number of underlying factors common to all of them. The exact weight of an individual factor may have varied during different periods but a more formal principal component analysis would have revealed their significance. These factors are:-

1) Need to obtain financial resources for resolving balance of payments problem;

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[2] The views expressed in this paper are those of the author and do not represent the views of the State Bank of Pakistan or the Government of Pakistan.

2) Secure access of funds from other international financial institutions and bilateral donors;

3) Get a 'Seal of approval' for seeking commercial and export credit facilities;

4) Shift the blame for some of the politically unpopular decisions to external pressures and compulsions;

5) The attempt of reformist economic managers to restrain and block the pursuit of populist policies by political leaders;

6) In post 1998 period to get debt relief and rescheduling.

The above catalog of motivating factors appears to be quite plausible and reasonable. The question then arises is: why did success in implementing these programs prove so elusive? There are several explanatory hypotheses, which are presented below.

First, it is interesting to note that the frequent changes in the government leadership led to new agreements with the IMF and one of the reasons cited for dismissal of directly elected governments was economic mismanagement. Whether the continuity of elected governments and completion of their full term would have made any significant difference as far as implementation of the IMF programs was concerned is the moot question. There is a viewpoint shared by the economic managers of the dismissed governments that these programs, even if they had gone off track temporarily, would have been back on track if there were no disruption of the political process. It would be pertinent to point out that there was no difference of opinion among the two major political parties who alternated in power in the 1990s as far as the nature of reforms was concerned. Their views also coincided with the IMF program contents. In other words, economic management and meeting the commitments with international financial community cannot be divorced from political management and the overwhelming reason for Pakistan's poor track record can be ascribed to the uncertainty and discontinuity caused by frequent changes in the government.

The second line of reasoning has been espoused by this author in his 1999 analysis of the Political Economy of reforms. According to this viewpoint the main motivation underlying these programs was not longer-term transformation of the economic structure but short-term injection of liquidity to avert foreign exchange shortages and replenish reserves. Adjustment was thus taken as a purely short-term palliative measure to buy time rather than an opportunity to introduce much desired policy and institutional changes. The vested interest groups which were likely to lose out from these reforms, had strong political and economic hold on the decision making process under every elected government. They were therefore instrumental in ensuring that only some cosmetic changes were made to obtain IMF and other external financing and then go ahead with business as usual. The leadership in Pakistan during this decade remained preoccupied mainly with the challenges of retaining power in the face of a vigilant military oversight and in building coalitions and alliances to preserve political power and thus sticking to the lowest common denominator acceptable.

The third hypothesis can be termed as 'Blame the IMF syndrome'. The proponents of this hypothesis argue that the diagnosis of the economic problems carried out by the IMF staff is partial and incomplete. As they do not have any grounding in the specific political realities or awareness of the institutional capacity their technical analysis is sound but does not capture the full feasibility of implementation of reforms. More damaging is the indictment that the design of the program is driven too much by dogmatic and ideological agenda of Wasgington Consensus i.e. liberalization, privatisation and deregulation. The IMF holds a uniform set of universal economic precepts to be valid across countries and the initial conditions, market imperfections, structural rigidities, immobility of factors and other peculiar features of developing economies do not seem to figure in the design and formulation of the programs.

A variant of this hypothesis argues that even when policy content is appropriate there is a great deal of resistance in accepting deviations and variances from the specified performance criteria. Nobody has perfect economic foresight to predict accurately the evolution of key variables over time. Unanticipated exogenous factors outside the control of the policy makers do influence the outcomes and the IMF staff and Board are more often inclined to ignore or give less weight to these factors during their review placing unreasonable demands for further adjustment upon the authorities. If the targets themselves resulted from unrealistic assumptions in the program design then throwing the entire weight upon the country is considered unreasonable. The strict adherence to quantitative indicators rather than a feel for the overall policy direction does create a dissonance between the Fund and the country authorities. The tendency to micromanage and second guess the authorities has been a consistent complaint against the IMF by those who have been engaged in negotiations with them.

What do we conclude about the relationship between the IMF and the successive governments during this period of 1988-99? My own reading of the evidence suggests that short term economic gains in tackling external sector imbalances by getting infusion of IMF and other external financial flows was the main driver of this relationship. Fundamental structural reforms that entailed heavy political costs were largely avoided or were cosmetic in nature, as these reforms would have added to the political insecurity with which these governments were already suffering. The struggle for surviving in the office was already quite messy and unpopular economic reforms would have accelerated their exit from the office sooner than later. This need for survival translated itself into poor governance and wasteful expenditures. The time inconsistency problem where the benefits of these reforms would have accrued to their opponents later while the costs would have been borne by them was upfront a real one.

What is different this time?

An interesting question that is raised these days in Pakistan is: why is it different this time that we have been able to complete the SBA without any hiatus and are on track in implementing the PRGF?

It must be recalled that the relationship between Pakistan and IMF in the early days of Musharraf Government was quite rocky and uneasy. The dismissal of a democratically elected government and take over by a military leader was not taken lightly by the major shareholders of the IMF. On the top of this, the new government had to inform the Board about the misreporting of the fiscal deficit data in the year 1998-99. Thus there was an air of suspicion, scepticism and lack of credibility about the country. Voices were raised at higher level of management and the Board about the country's track record in delivering on its commitments and promises to the international financial community. There was a little sympathy to the proposal made by the GOP that they were willing to implement all the conditionalities contained in the suspended ESAF/EFF program and that this program should be resumed. The IMF responded that a number of key conditionalities should be implemented as prior actions to demonstrate good faith by the new government. Even if these actions are taken the IMF management will only recommend a 10-month SBA for Pakistan and not the resumption of the medium term ESAF/EFF program. At that time the country had very few options, as default on external debt appeared quite imminent. An agreement with the IMF was thus essential in order to obtain rescheduling of its Paris Club debt. The GOP had thus to pay a heavy price for re-establishing the country's lost credibility and had to take some very tough measures as prior actions. These actions triggered the approval of the SBA by the IMF Board. Subsequently, the Government had to implement an equally tough set of additional measures to meet the performance criteria, structural benchmarks etc. during the next ten months. I would not go into the details of the measures at this stage but I am not aware if any other developing country had embarked on such a wide range of deep-rooted reforms during such a short span of time. This happened at a time when per capita incomes were stagnant, investment had declined during the previous five years, poverty was rising, fixed income groups had their salaries frozen since 1994 and widespread unemployment was a serious economic and social problem.

Why was there political willingness to implement these unpopular reforms that had been resisted for a long time by successive governments? My own reading leads me to the following conclusions: -

(a) That the country was on the verge of a serious financial crisis and the new government had assumed power with a commitment to avert this crisis;

(b) These reforms fitted in well with the strategic vision of President Musharraf;

(c) The team of technocrats commissioned to carry out the reforms possessed the requisite capacity and commitment; to design home grown program and

(d) Improved governance structure has facilitated the reform process.

(e) Stakeholder consultation provided a vehicle to broaden ownership in the formulation of the Poverty Reduction Strategy Paper (PRSP)

President Musharraf had committed to the nation at the time of take over that good governance, economic revival based on strong fundamentals and freedom from debt and social harmony were his main priorities. The distortions in the economy according to him were great inhibitors in achieving this vision and had to be removed. The diagnosis of the problems confronting the economy and the prescriptions required to fix them were shared by the government's economic team and the IMF and World Bank staff. Although there were differences of opinion about the intensity, sequencing, timing and phasing of various measures, there was no serious disagreement on the nature of the reforms to be undertaken. The thrust of reforms suggested by the IMF was in the areas of fiscal prudence; reducing indebtedness, competitive pricing of outputs, inputs and public utilities, widening tax base and strengthening tax administration; removal of concessions, exemptions and privileges, extension of a level playing field to all economic agents; greater reliance on market mechanism rather than administrative discretion in allocation of resources; privatisation of state owned banks, energy companies and other large enterprises. This concurrence between the new government's agenda, and the IMF program contents, the shared diagnosis of the problems and agreement on specification of remedial actions paved the way for smooth and uninterrupted implementation. It was not easy by any means. Public opinion, intelligentsia and popular media were all generally opposed to this program and several public office holders wished that the pace of reforms could be slowed down. But the clear headedness and steadfastness of the key decision maker of the country did not allow any significant slippages to take place. The GOP, also, for the first time made Poverty Reduction and Social Safety nets as explicit and integral part of its economic revival agenda. The underlying logic was clear: reforms would hurt the poor in more than one way, particularly, if subsidies are withdrawn and market prices are introduced. To help the poor cope with this burden the Government had to put in place poverty targeted interventions and social safety nets.

The results of the efforts during the last two and half years have been mixed. External sectors has been secured, debt burden indicators are falling, foreign exchange reserves are at a record high inflation is low, exchange rate has remained stable and governance has improved significantly among the higher echelons of the public officials. But growth has remained anaemic, investment is still elusive, poverty has not been dented, government revenues and exports have not reached the desirable levels and unemployment is still a burning issue. Of course, there have been a series of continuing exogenous shocks such as the unprecedented drought for last three years, global recession worsened by September 11 events, the war in Afghanistan, and growing tension with India. Domestic non-economic factors such as a virulent campaign against extremist and sectarian elements in the society and joining hands with the international community in their fight against terrorism have not helped much either. Institutional capacity constraints and the revolt of the previous powerful vested interests against this regime have exacerbated the situation.

What are the lessons for the IMF?

One of the important lessons that emerges is that the insistence on prior actions and conditions is widely perceived in Pakistan as an infringement of its national sovereignty. So even desirable policy reforms are resisted and opposed on this ground. It would thus be preferable if there is a minimalist approach in the specification of conditions by the IMF and more reliance is placed on the actions proposed and initiated by the governments themselves.

This reading of Pakistan case study would be incomplete if the changes in the attitude, behaviour and response capacity of the IMF are also not recognized. Once the track record and credibility of Pakistan were established the dialogue between the two sides became more productive and fruitful. There was a genuine desire to resolve outstanding issues in a spirit of openness and frank exchange. A better appreciation was exhibited about the variances and slippages from the agreed targets and when it was demonstrated beyond doubt that policy actions were appropriate and timely but other factors outside the control of the authorities could explain the deviations – waivers were granted consistently. For example, in relation to tax revenue targets where it became obvious that the underlying assumptions behind those targets were not validated by actual course of events the IMF staff accepted this deviation. The IMF staff and management were more forthcoming and showed understanding as far as fiscal deficit target was concerned when some one-off adjustments were made to clean up tax refunds to banks, to meet the accumulated losses of KESC, and to increase the defence expenditure due to troop mobilization at the borders. As long as the policy direction showed the trend of reduction in overall fiscal deficit and generation of primary surpluses, the IMF did not have a serious reservation on short term slip in fiscal deficit. So long as inflation remained muted the IMF did not object to the ease in monetary stance. But at the same time they were very vocal about the slow down in social sector spending or a cut in overall development expenditure. They were also keen on monitoring the impact of poverty related expenditures including targeted subsidies or transfers. The missions had interactions with a much larger segment of the Federal and Provincial Governments, business leaders, trade unions representatives and banking community. The Fund Resident Representative took advantage of public seminars and conferences to respond to the invalid criticism at the Fund program and was accessible to media. The transparency in putting out the Letters of Intent (LOI) and other documents is, in my view, a step forward to explain to the public at large the rationale and logic behind IMF assistance to Pakistan.

Of course, the image of IMF in developing countries and in Pakistan remains tarnished because of the burden of historical legacy, the increasing debate about the efficacy of the IMF programs during the Asian crisis and the political antecedents of a disproportionate influence of the US and Western countries on decision making. More success stories of mutual cooperation and trust between the countries and IMF have to be generated to improve this image. The feedback and second opinions emerging from the analyses of the Independent Evaluation Office (IEO) should also help improve the quality of internal governance within the IMF.

Conclusion:

The history of prolonged uses of fund resources in Pakistan can be divided into two periods. The first period between 1988-99 can be characterized as less successful in achieving the objectives set out in the programs agreed between the authorities and the IMF. Frequent changes in government reduced the time horizon of the decision makers and they avoided taking decisions with long term positive benefits but short term and immediate costs. They used IMF and other foreign resources to fix the external payment imbalances during the pendency of their regime but did not stick to the complementary policy reform which would have taken care of the root problems underlying these imbalances. Poor economic governance was very much an inhibitor in the pursuit of sound economic policies, programs and investment decisions.

The second period beginning in the year 2000 has started on a more positive footing. There is an essential concordance between ownership and conditionality as the agenda designed by the Government has the right mix of policy actions which can be reinforced and strengthened by conditionality of the IMF and other IFIs. The economic managers can turn around to these conditionalities to protect themselves from the pressures of undesirable policies and unproductive expenditures. But for this to happen on a sustained basis there is a need for the IMF to be more flexible and open minded in its approach, examine the evidence and the consequences of various policy options without benchmarking them to established orthodoxy. The IMF management have to give a much freer hand to the country missions and Area departments in the design and review of the programs compared to the current practice where the central departments almost enjoy veto powers and are the guardians of the Fund's orthodoxy. The highly intrusive role of the Fund's Board is also counter productive in so far as the staff and management keep on second guessing the Board members' reactions to the various innovative and untested ideas. The incentives for new approaches and non-conventional ways of thinking are thus non-existent and the urge to conform to the usual contours and space is highly compelling. The Managing Director's initiatives for the IMF to become a more learning and responsive cooperative institution trusted equally by African, Asian and Latin American member countries, will remain unfulfilled unless the role of the Board and the Central departments within the IMF are redefined. It is suggested that the IEO should be asked to examine the internal decision making process within the IMF..

Annex I

Pakistan and the IMF: 1988 – 2000

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Financial arrangements with the IMF

			(SDR million)		
Regime	**Period**		**Amounts agreed**	**Amounts drawn**	**% Undrawn**
	May 1972 – Nov. 1983 (5)		1,598	1,393	13
Bhutto / Nawaz Sharif	Dec. 88 – Dec. 91 (Dec. 92)	SAF	382	382	0
Bhutto	Dec. 88 – Mar. 90 (Nov. 90)	SBA	273	194	29
Qureshi / Bhutto	Sep. 93 – Sep. 94 (Feb. 94)	SBA	265	88	67
Bhutto	Feb. 94 – Feb. 97 (Dec. 95)	ESAF	606	172	72
Bhutto	Feb. 94 – Feb. 97 (Dec. 95)	EFF	380	123	68
Bhutto / Meraj Khalid / Nawaz Sharif	Dec. 95 – Mar. 97 (Sept. 97)	SBA	562	295	48
Nawaz Sharif	Oct. 97 – Oct. 00 (May 1999)	ESAF	682	265	61
Nawaz Sharif	Oct. 97 – Oct. 00 (May 1999)	EFF	455	113	75
	1988 – 1999		3,605	1,632	55
Musharaf	Nov. 00 – Sep. 01	SBA	465	465	0