**The IMF dilemma**

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**ONE of the challenges the new government will face immediately is to make a decision on whether or not to approach the IMF for financial relief.**

Pakistan borrowed nearly $8 billion from the IMF under its standby facility during 2008 and began repayments in 2011. The amount together with interest must be repaid by end 2014 — almost $5bn must be paid between March 2013 and end 2014.

A debate is raging between those who believe there is no alternative to entering a fresh programme with the Fund — standby or the Extended Fund Facility — and others who want to shun the IMF. To the former, the short-term liquidity situation leaves little choice.

Others believe the new government’s room for maneuverability will be constricted by the terms of agreement. To them, burdening the new government so heavily from the start seems unfair, as the price of the economy’s neglect is seen as being extracted from those who were not responsible. As someone who is familiar with the IMF from both the lender’s and borrower’s side one can advise a dispassionate and objective analysis and a realistic assessment of the options available before a decision is made.

There’s no doubt in anyone’s mind that Pakistan’s overall balance of payments position has worsened during the last five years and foreign exchange reserves have fallen to levels that cover hardly six weeks of imports. The rupee-dollar parity has recorded cumulative depreciation of almost 66pc since 2008. As a firm believer in the stability of the exchange rate as an indicator of market confidence, one can say this rate of depreciation has not benefited our export performance either.

Pakistan’s export growth during a period of relative exchange rate stability was higher than in the last five years of accelerated depreciation. Bangladesh, with a stronger currency than Pakistan’s, has overtaken us in textile exports. Meanwhile, foreign investors who were bringing in capital as they were assured that the returns on their investment in dollar terms remained remunerative because of a stable exchange rate have not been able to cross their hurdle rates of return.

Pakistan witnessed a large inflow of foreign capital by the private sector in 2001-07 that led to the accumulation of foreign exchange reserves and a stable exchange rate.  
Pakistan did not choose to draw down the last few tranches of the IMF loan in 2004 because it didn’t need the borrowed liquidity. For the first time we had successfully met all the performance criteria.

What does our past experience suggest for the current situation? The first question that must be answered is: what have we done with the $8bn borrowed from the Fund?  
Normally, a country facing a liquidity problem uses this amount to tide over temporary difficulties while undertaking adjustment and structural changes to ensure it will not face a similar situation in future.

We have done little towards structural improvement in tax, tariffs, energy pricing or losses of public sector enterprises. We have used this money instead of undertaking tough measures and making hard choices. In other words, we have eased the burden for ourselves temporarily without building our internal capacity to repay this large amount and other debts.

The next question is: if we are to approach the IMF again, are we ready to implement the measures we had agreed to in the 2008 programme? It will insist upon the fulfillment of these conditions as prior actions by us or as part of the new programme. Are we prepared to impose general sales tax in value added tax mode with minimal exemptions on traders, services and other sub-sectors outside the tax net thus far?

Will the Sindh government with a political configuration different from the federal government’s go along with this condition? Will this new government of whom the public has high expectations of relief from five years of hardship undertake such a large fiscal contraction i.e. 3.5pc of GDP from 7pc to 8pc currently? A 3.5pc adjustment particularly on the revenue account in such a short period would require harsh measures.

Will the finance ministry be able to eliminate State Bank financing for meeting its budget deficit and at the same time eliminate electricity tariff differential subsidies in the programme period? Does the federal government have the authority to insist the provinces contribute towards fiscal consolidation by generating surpluses? Will it be able to settle the large inter-corporate debt and bridge the gap in flows into energy-sector accounts (circular debt) so that this problem does not arise again?

Would the government have the capacity to manage its debt in a way that the ratio of public debt to GDP is brought down to 44pc from the current 62pc?

The government had committed to accelerating the privatisation process. There has been little significant privatisation since the Pakistan Steel case. Is the new government willing to stick its neck out? The benefits to the economy would be enormous. Will the finance minister amend the law and provide operational independence to the State Bank?

Only if the government is confident that it can implement these actions should it approach the IMF. Our credibility as a prolonged user of Fund resources is already quite low. We cannot afford another blow to our tarnished reputation. At the same time, domestic support of the IMF programme is weak. Thus, we are stuck between the devil and the deep sea. But if the answer to most of these questions is: ‘maybe’ or ‘not sure’ then we’ll be repeating the same mistake — borrow $5bn now, get off the track and then look for $5bn plus interest for repayment.

An agreement with the IMF will no doubt stabilise the foreign exchange market and arrest the depletion of State Bank reserves but if we remain hesitant to make adjustments to our economic governance structure, price-setting mechanism and policy responses, IMF borrowing will never prove successful.

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