# EXIT OF PAKISTAN FROM IMF: IMPLICATIONS FOR THE ECONOMY

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## *Abstract*

*International Monetary Fund (IMF) was established in December 1945. Pakistan became member of IMF in 1950. Due to poor economic conditions Pakistan sought help from IMF again in 2008. Fiscal programs of IMF have shown remarkable effects on economies of some countries. Yet in case of Pakistan there were negative effects. The primary reason is the non-compliance to the conditions agreed to at the time of obtaining loan. The factors leading to agreement were aimed to restore macroeconomic stability, bringing down inflation and strengthening foreign currency reserves. However later on, there was a continuous increase in budget deficit and inflation. Low level of economy and law and order situations affected the Fiscal policy of Pakistan. Lately, Government of Pakistan decided to quit IMF Program on its expiry on 30 September 2011, seemingly in view of fiscally better placed. In this paper an analysis has been made in view of post quitting scenario which may accrue to our economy.*


**Keywords:** International Monetary Fund, Pakistan, Conference, Monitory, Loans, Fiscal, Economy.

## Introduction

International Monetary Fund (IMF) was formally established in December 1945, as a result of outcome of Bretton Woods Conference held from 1-22 July 1944 in Bretton Woods, New Hampshire (USA), when legislative bodies from 44 states gathered for the United Nations Monetary and Financial Conference[1]. It was formed along with IBRD - International Bank for Reconstruction and Development – known as World Bank, that could not only restore the economy in future but to establish IMF for providing a platform to member countries for centralized consultations and collaboration on matters pertaining to international financing and related issues. The IMF and the World Bank lend money to member developing countries whose per capita income gross national product (GNP) exceeds 1305 US $ having serious balance of payment issues.[2]

We can divide Pakistan's history of using IMF into three distinctive phases. First phase (1970 to 1988), Pakistan had utilized for one-year SBAs (Stand by Agreements) with three-year Extended Fund Facility (EFF). Second phase

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(1988-1999), Pakistan availed both short term and long-term arrangements with the IMF. In the third phase, 2000-2004 Pakistan availed only one facility each of SBA and Poverty Reduction and Growth Fund (PRGF).

The reasons cited for quitting the program say that the administration has no balance of payment crises and sufficient foreign trade reserves to meet its international obligations like payment of loan installments etc.[3] The decision was formally conveyed to the Fund and World Bank meetings at Washington held from 23-25 September 2011[4]. Pakistan is one of those countries, which suffered negative effects after taking IMF loans, and probably it is due to non-compliance to the conditions, which were agreed to at the time of obtaining loans.

This research paper is intended to carry out in depth analysis of the conditions, Pakistan government's inability to carryout structural reforms, total IMF programs so far availed by Pakistan. Whether the country has been successful in achieving the desired aims and objectives or these programs further burdened the lives of common people and the impact of quitting IMF program on the economy of the country.

Standby Arrangement facility enabled Pakistan to implement a stabilization program that was characterized as development of tight economic policies to control the price rises and overcome the deficit in foreign current account. IMF, through this program wanted to bring low financial shortfall from 7.4 percent of the GDP (2007/08) to 3.3 percent (2009/10) by lowering public expenditure, eliminating tax exemptions, gradually withdrawing electricity subsidies and increasing electric tariff by 18 percent[5].

The study taking Pakistan as a test case to evaluate the conditions, their long-term impact on the overall economic growth, stability, the Fund's role in the fiscal management of Pakistan and *implications* on the economy after quitting the IMF Program. The study would be conducted in the following sections: In first section background, historical context, concepts, functions and dynamics of IMF Program are discussed; second section contained detailed IMF program, structured reforms, conditions imposed by the Fund, the country's success in realizing its goals or otherwise are also discussed; third section contained information on Structural Fiscal issues, measures to improve tax administration and collection and special initiatives taken by FBR to increase revenues; fourth section outlines the post program analysis and exit implications; the last section provided conclusion.

## Significance and Scope of the Study

The study aims to provide an inclusive overview of the core issues of prevailing economic conditions of Pakistan and numerous financial challenges it is facing and the policies to be adopted to meet the possible situations arising after quitting IMF program. The paper discusses the economic measures that constitute a condition for IMF disbursements to strengthen the economy and improve governance.

A well-designed program approximately the escalated strategy devised by the Planning Commission needs to be finalized and offered to polygonal agencies to assist in economic stabilization[6].

## Background

In the Federal Budget 2008-09, the government embarked on a stabilization program aimed at restoring macroeconomic and financial stability with enough protection for the poor. Four major challenges at that time were facing by Pakistan's economy: first, deterioration in economic growth, second, high inflation, third, rising financial deficit and fourth unfavorable extending gap in trade leading to quick reduction of overseas exchange reserves and plunging exchange rate. Economic growth was projected at 2%, inflation peaked 2.5% in August 2008, fiscal and current account deficit reached 7.6% and 8.5% in 2007-08, and exchange rate depreciated by 22% in six months[7].

Now Pakistan is not inclined to approach IMF for further facility. It appears that political considerations are of paramount importance then the country's economic interests. Now the situation is graver than it was prior to February 2008 general elections[8]. Pakistan's Finance Minister announced to quit the IMF's $ 11.3 billion program from 30 September 2011, Pakistan's public debt increased by Rs 60 billion due to increased dollarization amid fears of rise in inflation in the days to come[9]. In June 2011, the exchange rate was Rs 86 to one US dollar which appreciated to Rs 90 within few days, later State Bank of Pakistan intervened and pumped in dollars which bought the situation under control. Later Rupee again plunged to Rs 88.45 on 2 December 2011, thus increasing the public debt by Rs 130 billion[10]. It had earlier increased by Rs 180 billion when the Rupee depreciated by PRs 2.02 against dollar from June 2011 onward till the announcement was made.

Using IMF resources by Pakistan can be alienated into three different phases. Phase -1, (1970-1988), Pakistan had for one-year SBAs pursued by one three-year EFF. Phase-2, (1988-1999), had both the small term and multi-year arrangements with IMF. Phase -3, (2000-2004) Pakistan utilized one facility of SBA and PRGF each.

Pakistan signed second IMF program in 1965 by securing loan of 37 million SDRs. The third plan under SBA was obtained in 1972 by marked loan amount of 100 million SDRs. Similarly, fourth, fifth and sixth SBA programs were signed during former PM Z. A. Bhutto's era. During the government of General Zia-ul-Haq Pakistan and IMF had signed loan agreement worth 1.268 billion SDR in 1980; out of which Pakistan drew only 1.079 billion SDR till 1983[11]. Point to be noted that during the last two decades, almost 44% of the total loan has been drawn from the original 100% agreed upon loan due to weak government which could not act upon the firm procedures determined by the IMF. This tradition was broken for the first time in 2000 when Musharraf' came in power and implemented the conditions suggested by IMF and successfully withdrew the whole lending amount of 1.3 billion US dollars[12]. On 24 November 2008 Pakistan approached the IMF for availing the $18^{th}$ program with the Fund. At first, the loan amount allocated at 7.6 billion US dollars but later increased to 11.3 billion US dollars[13]

To sum up, Pakistan has received billions of dollars from the IMF under several schemes up to 1980. Table 1.1 below explains the details: -

## Table 1.1: Details of the Loan Arrangements with the Fund

| Date | Type | Date (Expiration or Cancellation) | SDR - Amount Agreed | Amount Drawn | Undrawn Balance |
|---|---|---|---|---|---|
| Nov 80 | EFF | Dec 81 | 1286 | 394 | 919 |
| Dec 81 | EFF | Dec 83 | 919 | 730 | 189 |
| Dec 88 | Standby | Nov 90 | 273.15 | 194.48 | 78.67 |
| Dec 88 | SAF | Dec 91 | 382.41 | 273.15 | 109.26 |
| Feb 94 | EFF | Feb 97 | 379.1 | - | - |
| Feb 94 | ESAF | Feb 97 | 606.6 | - | - |
| Dec 95 | Standby | Sep 97 | 401.85+160.74 | - | - |

The Table shows that most of the time whole amount was not obtained due to non-adherence to the conditions agreed to at the time of signing of the agreement. It is very sad to note that the conditions were for the betterment of economic health of the country but due to political issues then, despite agreeing to, were not implemented.

Pakistan faced a short fall in GDP growth rate and other economic gauges right after blend of IMF funds in the economy, apart from the second last lending agreement in Musharraf's tenure when full amount of loan was drawn successfully from IMF[14].

## The IMF Program

- Following a period of rapid growth, Pakistan began experiencing severe economic crises in late 2007 which started aggravating further in July-August 2008 due to unsustainable policy-induced imbalances in the economy leading to a macroeconomic crisis, external terms of trade shock, sharp rise in food and energy prices in 2008 coupled with the global financial crisis, which amplified the negative effects on the economies worldwide in general and Pakistan's economy in particular and finally adverse impact of war on terror on Pakistan.
- In the backdrop of this scenario, Pakistan signed Stand-By Accord with IMF for funding of SDR 5.1685 billion (7.6 billion US dollars) on 24 November, 2008. The Board conference held on 7 August 2009 and IMF approved an extension of SBA to SDR 7.2359 billion (10.66 billion US dollars)[15]

Most prominent points of SBA meeting with IMF in November 2008 are as under[16]:-

- SBA for 7.6 billion US dollars (SDR5.169 billion) signed.
- Augmentation of SBA by 200 percent increasing the total assistance to 10.66 billion US dollars (SDR 7.236 billion) in August 2009.
- Program period up to end-December 2010.
- Disbursements under the program thus far amount 8.7 billion US dollars, including 1.46 billion US dollars for budget financing.
- Five reviews of IMF SBA had been completed successfully.

Following key areas were selected for implementation of the program through reforms and corrective measures: -

- Tax enforcement regime to be further strengthened. In this connection FBR was required to suggest a summary of governmental alterations to the Parliament to correspond the Income Tax and GST laws.
- Government to increase social safety net spending.
- Prepare a plan for elimination of inter-corporate circular debt.
- Limit SBP financing of the budget.
- Implementation of VAT with minimum immunity to be directed by FBR during the Program period.
- Maintaining a Flexible Exchange Rate Regime[17].
- Fiscal deficit to decline from 7.6% of GDP in 2007-08 to 4.9% by 2009-10 and 2½% of GDP by 2012-13[18].

The fourth review of SBA was completed on 14 May 2010 with following salient: -

- Waiver request for the end of March maximum on the overall budget shortfall (grants are not including).
- All other structural and quantitative benchmarks set for March 2010 met barring SBP borrowing and slight slippage in fiscal deficit.
- As part of major structural benchmark, the Federal VAT bill was presented to the National Assembly and the provincial bills were proposed to the provincial assemblies.
- The current account deficit had improved as mentioned in table 2.1: -

## Table 2.1: Recent Account Deficit

| | $ Billion | % of GDP |
|---|---|---|
| 2007-08 | 13.9 | 8.5 |
| 2008-09 | 9.3 | 5.7 |
| 2009-10 | 3.5 | 2.0 |

- The Gross Foreign Exchange Reserves improved from import coverage of less than one month before SBA to about 4½ months of imports in June 2010. Details are shown in Table 2.2 on next page: -

## Table 2.2: Gross Foreign Exchange Reserves

| | $ Billion |
|---|---|
| End-October 2008 | 6.4 |
| End-June 2009 | 12.4 |
| End-June 2010 | 16.4 |

- Exchange rate which plunged by 22 percent between March 2008 and October 2008 remained stable up to August 2011[19].

Salient features of the fifth review are as under:

- Regarding 5th Review of the SBA were held in Washington DC from 23 August 23 to 2 September 2010. Technical discussions were held during August 23-25, 2010 for initial spadework and issues pertaining to end-June 2010 data and prospects for 2010-11.
- Some of the contentious issues emerged from 2009-10 data like slippages on revenue and expenditure accounts led to missing of fiscal deficit target as well as net zero borrowing from the SBP were brought in notice of IMF officials.
- There was general consensus among IMF team, MOF and the SBP about Macroeconomic Framework for fiscal year 2010-11. The underlying factors and impact of flood was assessed that brought the growth prospects down from 4.5% to 2.5%. The inflation escalated from previously projected 9.5-10% to 13%. The higher imports because of floods were likely to exert pressure on the current account deficit which was projected to reach 3.4% of GDP[20]. Apart from these agreements, there were disagreements as well.
- Ministry of Finance presented the case for fiscal deficit of 4% of GDP based upon assumption of FBR tax revenue of Rs. 1689 billion including Rs. 85 billion worth of revenue and revenue measures, and lower subsidy on electricity.
- The structural benchmarks like elimination of circular debt and implementation of VAT/Reformed GST remained at the center stage of policy meetings.
- Regarding energy sector issues an understanding were to be reached among the trio of GOP, ADB and World Bank.

- Regarding progress on Reformed GST, the mechanism to align draft legislation in line with understanding reached with the Government of Sindh was discussed.
- It was also agreed that Pakistan may draw first of the remaining two installments based on end-June 2010 benchmarks and next tranche based on end-September/ December 2010 benchmarks. In the meanwhile, IMF will monitor seriousness of Pakistan's commitments until September before initiating the Staff Report for the Board.

## Overview of Progress on SBA

Following are the successes: -

- Since November 2008, Pakistan pursued Stabilization Program amidst extremely hostile external and domestic environment. For the first five quarters of its implementation (January 2009 to March 2010) policy implementation had been good. Pakistan successfully completed four quarterly reviews of the SBA in extremely testing times.
- All quantitative performance criteria and the structural benchmarks were met. The government had taken several painful and politically tough decisions for the sake of stabilization and economic stabilization program and surmounted many obstacles[21]
- Although agreed reforms and procuring of foreign loan through IMF at a crucial juncture had a positive impact in initial phase as it relieved pressure on foreign exchange reserve and stabilized the currency performance of Pakistan remained satisfactory till March 2011.
- An overview of successes for end-June 2010 is précised in the table 2.3: -

### Table 2.3: Achievements for End-June 2010

| **Quantitative Targets for 2009-10** | | **Likely Outcome** | |
|---|---|---|---|
| Floor on NFA Stock ($ Billions) | 5.2 | 5.8 | Met |
| NDA Stock Ceiling (Rs. Billion) | 1320 | 5108 | Met |
| Continuous Ceiling on Forex | 2.5 | 2.7 | Met |

Fiscal policy was affected due to following reasons: -

- The desired increase in tax to GDP ratio could not be achieved due to politicization of the issue resultantly VAT or RGST could not be introduced.

- Proposed SBP autonomy could not be implemented and the draft bill is still lying with the parliament for approval.
- Reforms meant for power sector like elimination of subsidies and full cost recovery and elimination of inter-corporate circular debt could not be successfully implemented for a variety of reasons.
- An overview of failures for end-June 2010 is mentioned in the table 2.4: -

## Table 2.4: Deficits for End-June 2010

| Quantitative Targets for 2009-10 | | Likely Outcome | |
|---|---|---|---|
| Fiscal Deficit (% of GDP) | 5.1% | 6.2% | Breached |
| FBR Revenue (Rs. Billion) | 1380 | 1325 | Breached |
| Net Borrowing from SBP | 0 | 44 | Breached |
| Government Borrowing from SBP (Stock in Rs. Billion) | 1130 | 1208 | Breached |
| **Structural Benchmarks for 2009-10** | | | |
| VAT Implementation | July 01, 2010 | Replaced by Reformed GST | Not Met |
| Amendment in SBP Act | July 01, 2010 | In Parliament | Not Met |

## Actions to Improve Tax Administration and Collection

Current measures are taken to develop tax management and support tax collection is as under: -

- 8 to 12 members are reduced after the result of downsizing. One Member (Inland Revenue) has replaced the two Members responsibilities.
- The functional distribution and distribution of work (separation of functions of audit, enforcement and legal) will be implemented only up to the Additional Commissioner (Inland Revenue) level who will report to the Commissioner.

Till December 2010 10% of the identified non-registered, income tax non-filers had filed returns whereas 18% of the identified non-registered sales tax and federal excise non-filers had filed returns. A short-term enforcement plan has been developed with following targets:

- Completing desk audit of all corporate Income Tax returns for the FY 10 by 15th March and then initiating compliance by non-filers.
- Monitoring and audit of Withholding Tax agents specially banks, air ticketing agents and motor vehicle authorities since statistics indicate that the budgetary measures taken for FY 11 in respect of the identified three areas, are not generating the estimated revenues.
- Collection of stuck-up arrears by arranging special court benches for speedy hearing of the cases.

July 2009 - June 2010 (Tax Year 2008) Composite Audit figures are given in Table 3.1 and 3.2: -

### Table 3.1: Composite Audit Figures

| | Allocated Targets | Audits Completed | Demand Created (Rs. Millions) | Amount Recovered (Rs. Millions) |
|---|---|---|---|---|
| AOP | 453 | 81 | 9 | 3 |
| Company | 468 | 25 | 135 | - |
| Total | 921 | 106 | 144 | 3 |

### Table 3.2: Other Audits - Tax Wise

| | No. of Audits Completed | Demand Created (Rs. Millions) | Amount Recovered (Rs. Millions) |
|---|---|---|---|
| Income Tax | 60677 | 116636 | 61697 |
| Sales Tax | 353 | 36975 | 2360 |
| Total | 61030 | 153611 | 64057 |

## Audit Policy 2010-11 (Tax Returns 2009)

Audit policy and risk criteria was formulated for the fiscal year 2010-11 (for Returns of 2009), after getting inputs from the relevant quarters and sent to the field formations for implementation. Salient are as under: -

- To follow the risk-based criterion for selection of cases for audit instead of random for almost all types of audits.
- Exceptional Management System (XMS), already developed and deployed by M/s PRAL to be used effectively.

- Audit selection to be done by RTO & LTU, based on parametric short-listing and local knowledge.
- Reasons for selection of a case are to be recorded and communicated to the concerned taxpayer.
- Audit staff training needs shall be indigenously enhanced.

Cases for composite audits were selected by the relevant field formations in accordance with the Audit Plan and the audit activities were in progress. The latest progress report in this respect is given in Table 3.3 and 3.4: -

### Table 3.3: Audit Performance: July 2010 - June 2011

| | No. of Audits Completed | Claim Created (Rs. Millions) | Amount Recovered (Rs. Millions) |
|---|---|---|---|
| AOP | 80 | 18 | 01 |
| Corporation | 04 | 16 | - |
| Total | 84 | 34 | 01 |

### Table 3.4: Other Audits - Tax Wise

| | No. of Audits Completed | Demand Created (Rs. Millions) | Amount Recovered (Rs. Millions) |
|---|---|---|---|
| Income Tax | 2272 | 30114 | 3273 |
| Sales Tax | 196 | 7376 | 16 |
| Total | 2468 | 37490 | 3289 |

## Initiatives Taken by FBR

- Inadmissible input tax adjustment of Sales Tax involving more than Rs.24 billion and supplies made by blacklisted units of Rs. 16.5 billion has been identified and sent to field formations for verification/audit. The cases are under process and substantial amount is expected to be recovered.
- Approval was accorded for audit of 77 taxpayers involving irregularities pointed out by field formations. As an outcome, detection of about Rs. 7 billion was made by only LTU Karachi out of which recovery of about Rs. 4 billion had so far been made in 4 cases. Similarly, the LTU, Lahore had detected an amount of Rs. 11 billion in 40 cases and an amount of Rs. 03 billion had been recovered so far.

## Post IMF Program Analysis

IMF Stand-By loan was meant to allow Pakistan impose a stabilization program that visualized major reduction of fiscal and monetary policies to bring down price rises and decrease the foreign current account debit to more maintainable levels. In this way IMF wanted a decline in the fiscal deficit from 7.4 percent of GDP in 2007/08 to 4.2 percent to a more manageable 4.2 percent in 2008/09 and 3.3 percent in 2009/2010[22]. In fact, in April, 2011, IMF appreciated Pakistan for preparing very well. Some of the important achievements made till then are as under:

- External position had strengthened; the exchange rate stayed stable till August 2011. Existing account deficit also pointed significantly which was assisted by lower imports, elevated exports and a strong increase in payments from abroad.
- External currency treasury also enlarged from 3.3 billion US dollars in November 2008 (before the SBA approval) to over 18 billion US dollars in July 2011.
- Initially with the introduction of reforms under SBA, the macro-economic indicators had the signs of improvements like stable exchange rate and foreign currency reserves. The external position improved with substantial decrease in Current Account Deficit (CAD) accompanied by improvement in financial and capital account. Gross official for ex reserves increased to around $11 Billion and deposits in the banking system began to recover. As an effect of lower foodstuff and power prices, inflation declined from 25% to 13.7% in January 2010. The overall fiscal deficit also remained within the prescribed limit in 2009-10[23].
- Petroleum subsidies were eliminated in 2008 which had a positive effect on overall macro-economic situation of the economy, though there was resentment against this... In order to introduce new mechanism for social safety net for lower income groups, the government introduced necessary changes in the Benazir Income Support Program.

However, the desired objectives/goals could not be fully achieved for the reasons as mentioned below: -

- Enough revenues could not be generated through internal resources, as steps required for the same, like introduction of value added tax etc were not taken, were rather politicized. As a result, borrowing from central bank and others were relied upon which consequently led to high inflation, increased fiscal deficit and low growth.

- Circular debt problem could not be solved and the nation is still haunted by this grave problem which is not only affecting the masses but also adversely affecting our manufacturing sector leading to low GDP growth.
- Reforms in SBP and energy sector were not taken to logical end and as a result the basic flaws noticed by IMF and our economic managers could not be rectified.
- The devastating floods in 2010 and heavy rainfall in 2011 in Sindh and instability in the cost of food items and petroleum further exacerbated the problem which hit our fragile economy adversely. This resulted in low GDP growth @ 2.4% and tax to GDP ratio to record low level[24]. If increase in exports and foreign remittances had not come to the rescue of the economy, we would have faced another crisis like one in 2008.

## Decision to Quit IMF Program - Economic Implications

Following are some of the likely implications for the economy of Pakistan of quitting IMF program: -

- The recent decision of quitting IMF Program will give the current government a political power especially in upcoming elections. Self-reliance will be developed in the public of Pakistan.
- Refuting such a loan facility may be a good populist move for the government in view of election years but may not go well with the economic conditions of the country in of different challenges like Taliban uprising, crippling power cuts and growing balance of payments.
- Quitting the IMF program means less foreign inflows and the government will have to print more currency notes to bridge the budget deficit. The cost of all imported stuff such as petroleum products, furnace oil and food items particularly palm oil will go further up.
- The circular debt in the energy sector will also increase in the wake of increase in the price of imported furnace oil used for internal power generation. This will push the cost of electricity up further and if the government does not increase the power tariff for political reasons, then it will be left with no option but to increase the subsidy in the power sector.

- Pakistan this year had to import vegetables from India because of the damage caused to vegetables in Sindh by the recent floods. The imported vegetables also cost more, as will be the raw material, which is imported for the export-oriented industry. As a result, Pakistani products will become costlier and less competitive in international markets.

The outlook for FY 2011-2012, however, does not look promising because of a variety factors. First and foremost is the plight of cotton where the commodity's prices have already softened. This has leaded the country's economic managers to revise GDP growth target for the current fiscal year from 4.2 % to 3.5 %. Moreover, world oil prices are likely to sore during the current fiscal year badly impacting country's trade balance.

Government would make its best efforts to achieve the fiscal deficit target for FY 2011-2012.In the past, US political support helped Pakistan make a comfortable arrangement with the international financial institutions but this year the Americans appear reluctant to provide that support.

## Conclusion

Unless we ourselves manage our affairs with commitment and in a professional manner no program can alter the fate of our economy. Foresightedness along with wisdom and political will are the essential requirements which should motivate the masses to contribute to the national exchequer by setting examples. No other foreign donor agency or organization can help us unless we are prepared to change our own destiny through tight fiscal measures. There was nothing wrong with conditions/parameters laid down by IMF but our level of commitment and sense of responsibility are the missing links between the goals and achievements.

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