Impact of the IMF Programs: A Context of Pakistan

The Federation of Pakistan Chambers of Commerce & Industry

Policy Advisory Board

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Acronyms

ALMA	Active Liability Management Act
AML	Anti-Money Laundering
BA	Before- After Approach
BISP	Benazir Income Support Program
CBI	Central Bank Independence
CBSL	Central Bank of Sri Lanka
CFT	Combating Financing Terrorism
CPPA	Central Power Purchasing Agency
DPCO	Debt Policy Coordination Office
EU	European Union
ECF	Extended Credit Facility
EEC	Ehsaas Emergency Cash
EFF	Extended Fund Facility
EPCC	Economic Policy Coordination Committee
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FRDLA	Fiscal Responsibility and Debt Limitation Act
FTA	Free Trade Agreement
FX	Foreign Exchange
FY	Fiscal Year
GDP	Gross Domestic Product
GEE	Generalized Evaluation Estimator
GENCO	Generation Company
GFC	Global Financial Crisis
IMF	International Monetary Fund
IT	Indicative Target
KPP	Kamyab Pakistan Program
LM	Lagrange Multiplier
MFPCB	Monetary and Fiscal Policies Coordination Board
NAB	National Accountability Board
NEPRA	National Electric Power Regulatory Authority
NFC	National Finance Commission
NHA	National Highway Authority
NSER	National Socio-Economic Registry
OLS	Ordinary Least Squares
PEPCO	Pakistan Electric Power Company
PES	Pakistan Economic Survey
PIA	Pakistan International Airlines
PIDE	Pakistan Institute of Development Economics
PKR	Pakistan Rupee
PLL	Precautionary and Liquidity Line
PMLN	Pakistan Muslim League-N
PPP	Pakistan People's Party
PRGF	Poverty Reduction and Growth Facility PSM Pakistan Steel Mills
PTA	Preferential Trade Agreement
PTI	Pakistan Tehreek-e-Insaf
PWC	Post Washington Consensus
QPC	Quantitative Performance Criteria
RFI	Rapid Financial Instrument
RGDP	Real Gross Domestic Product
RCF	Rapid Credit Facility
ROC	Review of Program Design and Conditionality
SB	Structural Benchmark
SBA	State Bank of Pakistan
SCI	Statements of Corporate Intent
SDR	Special Drawing Right
SIM	Simulations
SMEs	Small and Medium Enterprises
SOE	State-owned Enterprises
TOT	Terms of Trade
TPC	Trading Corporation of Pakistan
UCT	Unconditional Cash Transfers
UNICEF	United Nations International Children's Emergency Fund
USC	Utilitiy Stores Corporation
USD	US Dollar
VAT	Value Added Tax
WAPDA	Water and Power Development Authority
WC	Washington Consensus WeT Waseela-e-Taleem
WeT	Waseela-e-Taleem
YoY	Year-on-Year

Executive Summary

International Monetary Fund (IMF) witnessed a gradual shift in the policies advocated by the institution over years. IMF was established with its initial objective of being the promoter of international trade through global exchange rate regimes and payments. However, the role of the IMF has dramatically shifted from the global financial institution to the lender of last resort in response to global changes for ailing economies to tackle balance-of-payment problems, restore stability, and promote sustainable economic growth. The IMF offers a range of lending facilities to fulfill its mandate depending upon its nature, tenure, and conditionalities. However, developing countries commonly sought three facilities including Standby Arrangements (SBA), Extended Credit Facility (ECF), and Extended Fund Facility (EFF).

The Fund's roots can be traced back to the 1989's Washington Consensus (WC) which fundamentally outlined ten economic policies for the development of Latin American countries backed by the theoretical framework of neoclassical economics espousing firm belief in the market's 'invisible hands', the rationality of economic actors, and a minimalistic version of state regulations of the economy. However, the IMF faced extensive criticism and was compelled to revisit the reforms after fault lines erupted in its programs, especially after the East Asian, Argentine, and Korean crises. These reforms mainly aimed to address good governance, social sustainability, and regulatory reforms which were not part of reforms in the older version. It was later named Post Washington Consensus. However, following the failure in achieving its targets, IMF reviewed its performance and associated conditionalities along with the program's design again and has currently been following a limited edition of policies.

The IMF has been criticized for making developing economies dependent on Fund's resources and it is regarded as the 'neocolonialist trap'. Pakistan is among the prolonged user of the IMF program which pursued the highest number of programs as compared to the other South Asian economies. It entered into its first IMF program in 1958 and sought the highest number of loans in the "Lost Decade" during the 1990s. One of the crucial reasons for the country's repetitive engagements with the IMF is the import-oriented energy policy which drains the forex reserves during global oil price shocks. It sought at least 15 out of 23 programs so far during the global surge in oil prices. Energy sector reforms in the 1990s prescribed by the donor agencies added at least 16 imported furnace oil and gas-based Independent Power Producers (IPPs) to the system. The other major reasons include poor management of fiscal resources, massive current account deficits, rent-seeking political economy, and flawed design of IMF Programs. Respective governments in Pakistan have failed to avoid IMF assistance and have continued seeking temporary relief rather than focusing on structural changes. The empirical findings based on the historical data highlighted that IMF programs have a significant impact in curbing the twin deficits whereas these programs have adverse impacts on industry and

economic growth. The generic set of measures under IMF programs historically failed to address the structural challenges to the economy but deteriorated the macroeconomic outlook. The average industrial growth and GDP growth were lowered by 2.27 and 1.44 percentage points respectively during periods when Pakistan underwent IMF programs as compared to periods without IMF programs. Similarly, both higher interest rates and inflation during the IMF programs question the efficacy of maintaining positive real interest rates as a tool to control inflation as prescribed by the IMF. Typical case studies of countries that are the prolonged users of these programs including Ghana and Sri Lanka as well as countries that successfully implemented home-grown strategies to come out from these programs such as Turkiye and Indonesia are also discussed.

Pakistan entered into the 22nd IMF program in 2019 which was stalled during the pandemic but later resumed. The country was once again hammered with a more stringent set of reforms pertaining to fiscal consolidation, improving safety nets, flexible exchange rates, tightening monetary policy, the autonomy of the State Bank of Pakistan (SBP), SOE reforms, and others. However, most of the implemented reforms appear counterproductive such as the country posted record inflation of 31.5 percent in February 2023 despite the perpetual hikes in policy rates. Similarly, the market-based flexible exchange rate regime rather deteriorated the export-to-import ratio to 40% in FY2022 as compared to 42% in FY2019.

In order to fix the recurrent economic crisis, a consensus on the economic plan with clear objectives and economic targets for 20-30 years is inevitable. The proposed homegrown model to cease dependence on the IMF also include a prudent debt strategy, energy sector reforms, avoidance of politically motivated economic decisions, and fiscal reforms that are tailored to the country’s unique dynamics.

1. Introduction

International Monetary Fund (IMF) was established as a financial institution in the wake of World War II in 1945 with the primary objective to manage the global exchange rate regimes and international payments.[1] Over the years, the objective of the International Monetary Fund has evolved from financial assistance to countries to tackle the balance of payments and restore sustainable economic growth. It is a cooperative body with 190 members (2022) divided into creditor and debtor countries. The current objectives other than facilitating international trade include promoting employment, sustainable economic growth, and reducing poverty. The IMF utilizes a range of lending facilities to fulfill its mandate, however, the most common and historic lending facilities include Standby Arrangement (SBA)[2], Extended Credit Facility (ECF),[3] and Extended Fund Facility (EFF)[4]. These programs are differentiated based on lending rate, repayment tenure, and eligibility criteria.

i. Standby Arrangement (SBA)

The Standby Arrangement (SBA) can be considered as short-term financing for a country facing a balance of payment restraints with a withdrawing limit in accordance with the economy's capacity to pay back with little to zero conditions, typically covering 12 to 24 months. SBA remains the IMF's primary vehicle to provide funds quickly to member countries with emerging balance of payments crises. Repayment of such loans becomes due in eight equal quarterly installments within 3¼ - 5 years after the date of each disbursement. SBAs usually target reduced expenditures. It is most commonly used by middle-income countries, however, also pursued by advanced economies amid the pandemic.

ii. Extended Credit Facility (ECF)

The Extended Credit Facility (ECF) is medium-term support to low-income countries, facing a balance of payment problem with objectively focusing on a stable and sustainable macroeconomic position in an alignment of poverty reduction and growth. It was also previously known as Poverty Reduction and Growth Facility (PRGF). IMF prescribes a set of conditions with the intent of improving the country's progress toward a stable and sustainable macroeconomic position under this facility. ECF financing is highly concessional, with a zero-interest rate in a period of five and a half years with a final maturity of ten years.

iii. Extended Fund Facility (EFF)

Countries facing balance-of-payment imbalances due to structural weaknesses or slow growth approach for EFF. The main aim of EFF is to provide support for comprehensive programs including the policies needed to correct structural imbalances over an extended period while repayments are made over 4½-10 years in six years period of twelve equal semiannual installments. In contrast to SBA, EFF has a strong focus on structural adjustments, a country's performance is judged on not only macroeconomic conditions but also on the committed adjustments in the structure. The lending rate on these facilities includes the basic rate of charge and surcharge. The surcharge depends upon the amount and time the credit is outstanding.

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[1] https://www.cfr.org/backgrounder/imf-worlds-controversial-financial-firefighter
[2] https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/33/Stand-By-Arrangement
[3] https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/04/Extended-Credit-Facility
[4] https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/56/Extended-Fund-Facility

Table 1: IMF Common Lending Facilities

	Lending Facility	Nature	Eligibility	Tenure	Access (% of Quota)*	Conditions	Maturity Period
Short Term	Standby-Arrangement (SBA)	Balance of Payments	Middle-income and Advanced Economies	12-24 months	145%	Fewer conditions	3.5 – 5 years
	Flexible Credit Line (FCL)	Cash crunch	Countries with very strong Macroeconomic Fundamentals	1 or 2 years	No cap/limit for access	No Conditions	3.5 - 5 years
	Precautionary and Liquidity Line (PLL)	Domestic and External shocks	Countries with moderate Macroeconomic Fundamentals	6, 1or 2 years	125%, 250% in case of external shock	Ex-Post Conditions	
	Standby Credit Facility (SCF)	Precautionary Basis Domestic or external shocks	Low-income countries	12 to 36 months	145%	Quantitative Conditions, Structural Benchmarks	4 - 8 years
	Rapid Credit Facility (RCF)	Urgent Basis	Low-income countries	One-off disbursement	50% of quota per year, Cumulative: 100% of quota	-	5.5 - 10 years
	Rapid Financial Instrument (RFI)**	(i) Natural Disaster (ii) Transitory Shock	All countries other than low-income	One-off disbursement	(i) 50% (ii) 80%	Prior Action if needed	3.5-5 years
Medium Term	Extended Credit Facility (ECF)	Medium to Long-term	Low-income Countries	3-5 years	145%	Limited Conditions-Ex-Post	5.5-10 years
Long Term	Extended Fund Facility (EFF)	Structural Adjustments	Low-income Countries	4 years	145%	Soft and Hard Conditions	4.5-10 years
Non-Financial	Policy Coordination Instrument	Domestic and External Shock	All members	6 months to 4 years	-	-	-
	Policy Support Instrument	Domestic	Low-income countries	1-4 years, Extended to 5 years	-	-	-

**Quotas during Covid-19 were temporarily increased*

Note: The table lists the most commonly used facilities of the IMF
Source: International Monetary Fund (IMF)

The IMF's mission is to provide financial assistance to member countries when needed to tackle balance-of-payment problems, restore stability, and promote sustainable economic growth. Poor macroeconomic conditions and distorted current account balance are the prime reasons for a country to choose the IMF program. Drivers of the IMF lending program are as follows:

(i) Serious current account problems and unable to meet financial obligations through internal resources generated in the form of taxes, external sources such as Foreign Direct Investment (FDI), and debt (Joyce, 1992; Bird & Rowlands, 2017)

(ii) High level of public and external debt and large current account deficit due to mismanagement of fiscal and monetary policies (Bird, 2007),

(iii) Depleting foreign exchange reserves and banking/financial sector failure (Hussain, 2010),

(iv) Assistance during both domestic and global crises.

Most African countries as well as South Asian economies such as Pakistan and Sri Lanka have been prolonged users of IMF programs implying their unhealthy economic conditions. However, the Global Financial Crisis of 2008 and the ensuing European debt crisis have forced developed European countries such as Ireland, Greece, and Iceland to seek bailout packages for the first time. International financial markets feel reluctant to invest in the economy's dependent on IMF. In the wake of the pandemic, IMF adopted extraordinary measures worth $16 trillion by increasing the access limits of lending facilities to avoid the COVID-induced global crisis in 2020.

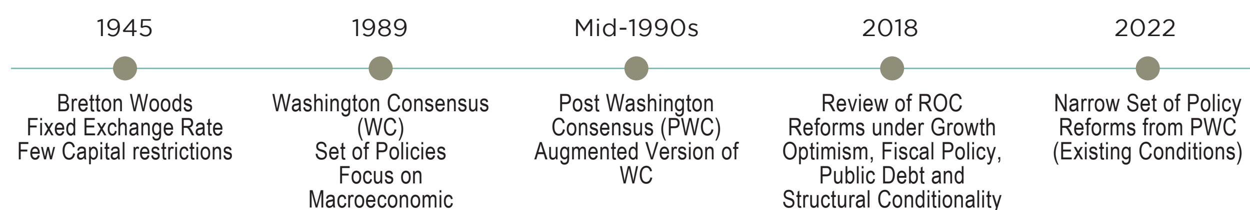
Literature is also extensive in exploring the impact of IMF programs on economic growth. Anton (2016) argues an adverse impact of undertaking IMF Programs on Foreign Direct Investment (FDI). Haque and Khan (1998) found a negative relationship between the IMF and growth in Pakistan in the short-run due to demand restraining policies of the IMF. Several studies (Barro & Lee, 2003; Przeworski & Vreeland, 2000; Stiglitz, 2000; Butkiewicz & Yanikkaya, 2005) claim that these IMF programs only cause more harm than benefits to the recipients. Dreher (2009) criticizes the repetitive engagement of middle and low-income countries with the IMF argued that there had been no need to approach the IMF time and again had the conditional loans fulfilled their intended goals. In addition, Killick et al. (1995) and Bird and Rowland (2017) have found contrasting evidence that IMF programs lead to improvement in growth and the current account balance of the borrowing countries.

2. The Evolution of The IMF Program

2.1. History and Roots of the IMF

International Monetary Fund's mandate, focus and, structural programs have evolved considerably over time concerning its objectives and set of policies it adopts. For instance, IMF's stance on the exchange rate regime has shifted from a fixed exchange rate to a flexible exchange rate regime. It has gone through different phases and followed criticism but following four changes induced major changes in the IMF's presence and policies The following figure presents the timeline of significant policy changes under the IMF since its inception.

Figure 1: Major Changes in IMF



IMF adopted financial liberalization and liquidity policies after the 1973's Oil Crisis and 1980s Debt Crisis. During the late 1980s, structural reforms, fiscal discipline and exchange rate liberalization policies became popular. It was followed by increased use of policies heavily influenced by the Post-Washington Consensus involving interest rate liberalization, central bank independence, and privatization in the early 1990s. The remaining policies namely capital account openness and flexible labor markets rose in importance after the mid-1990s (Kaya & Reay, 2019).

2.1.1. Bretton Woods

After the establishment of the IMF, the member countries were asked to fix their currencies (adjustable within 1%) to the US dollar and the dollar was fixed at $35 an ounce. In addition, countries could impose capital control restrictions only on the financial account and not on the current account (trade). However, the Bretton Woods System collapsed in 1973. After the collapse, the member countries were allowed to adopt any foreign exchange rate regime freely until the Washington Consensus.[5]

2.1.2. Washington Consensus (WC), 1989

The set of IMF policies takes its genesis from what was prescribed under Washington Consensus during the 1980s. The term 'Washington Consensus' was coined from a simple set of ten economic policies outlined in 1989 which were widely supported by power circles in Washington DC including the International Monetary Fund (IMF), the World Bank, the US Congress and other influential economists of that time. The underlying theoretical foundation is in the essence of neoclassical economics espousing firm belief in the market's 'invisible hands', the rationality of economic actors, and a minimalistic version of state regulations of the economy.

[5]https://saylordotorg.github.io/text_internaxtional-economics-theory-and-policy/s15-04-international macroeconomic-in.html
https://www.nber.org/system/files/chapters/c6867/c6867.pdf

Table 2: Set of policies under the Washington Consensus

S.No.	Policy	Explanation
1	Fiscal Discipline	A balanced budget is enough to prevent the BoP crisis and high inflation.
2	Prioritized	Redirecting spending from subsidies, and tax exemptions (which creates economic distortion) to
	Public Spending	neglected and pro-growth fields that could improve income distribution as well such as health, education and infrastructure.
3	Tax Reform	Increasing tax revenues as an alternative to the tax base and simplifying the tax system to enhance tax efficiency is the core element of this policy.
4	Interest Rates	The interest rates should be market determined without political intervention. The real interest rates should be positive but moderate to avoid capital flight and an explosion in government debt.
5	Exchange Rate	A uniform market competitive exchange rate should be adopted to increase the competitiveness of exports.
6	Trade Liberalization	Barriers to foreign trade should be minimized to promote international trade.
7	Foreign Direct	Restricting foreign investment increases monopoly and reducing market competitiveness. Government
	Investment	should reduce the barriers to FDI inflows which will increase capital gain, employment, and new skills for local labor.
8	Privatization	Privatization of state-owned enterprises as these are inefficient. This will increase the efficiency, business profitability and national output.
9	Deregulation	Government should remove the regulations which restrict the market entry of new firms hampering the market competition.
10	Property Rights	The country's legal system should provide secure property rights at low costs and be easily available.

Source: Williamson (1990) and Birdsall et al. (2010)

These policies were initially designed for developing Latin American countries to liberalize various sectors of the economy with the objective of growing efficiency and output. However, these policies have also been applied in different regions other than Latin America such as Asia, Africa, Eastern Europe and Central Asia in the last two decades.

2.1.3. Post-Washington Consensus (PWC), the 1990s

The advocates of the Washington Consensus argued that it is important to stabilize the exchange rates in times of crisis through cuts in public spending, imposition of higher taxes, raising interest rates and other recessive measures. The policies' emphasis on tightening fiscal policy and liberalization of trade and financial sectors have adverse effects such as increased poverty, reduce real wages, unemployment, and social decay. Rather, the adoption of such policies resulted in stagnant or slow growth in various developing countries such as Bolivia, Nigeria, and Zambia (Adefulu, 1991). Washington Consensus failed to understand the economic structures within developing countries. The policy reforms implemented in debt-affected countries in Latin America and Africa led to high unemployment, poverty rise, and unequal income distribution (UNICEF report Adjustment with a Human Face, 1987). Following are the major critics of the Washington Consensus;

(i) Stiglitz (2001 & 2013): Washington Consensus has neglected some important issues such as sound financial regulations, competition policy, and policies for technology transfer. Moreover, sharp increases in interest rates would contribute to the deepening of the crisis

(ii) Stewart (1991): Increases poverty because 'adjustment and stabilization policies tend to depress real wages, as control over money wages is combined with devaluation'

(iii) Adefulu (1991): Unemployment coupled with other various adverse effects from such policies on the poor in a country leads to social decay.

(iv) Naim (1999): Taking recessive measures during the necessary period further leads the country towards depression.

Failure of this approach had given space to different critics as discussed above, especially after the East Asian crisis, and the Argentine and Korean crises. The policy reforms advocated a comprehensive framework emphasizing good governance, social sustainability and regulatory reforms which were not addressed in the old version. The reforms were later named Post Washington Consensus (PWC) or Augmented Washington Consensus. The following table lists the reforms introduced.

Table 3: Original versus Post-Washington Consensus

The Original Washington Consensus (1989)	Post Washington Consensus
	The original list plus:
- Fiscal discipline	- Legal/political reform
- Reorientation of public expenditures	- Regulatory institutions
- Tax reform	- Anti-corruption
- Financial liberalization	- Labor market flexibility
- Unified & competitive exchange rates	- WTO agreements
- Trade liberalization	- Financial codes and standards
- Openness of FDI	- "Prudent" capital-account opening
- Privatization	- Non-intermediate exchange rate regimes
- Deregulation	- Social safety nets
- Secure property rights	- Poverty reduction

Source: Rodrik (2002)

However, Belinda Archibong et al. (2021) argued that the socioeconomic side of Post-Washington Consensus (PWC) policies has been ignored. Some of the policies adopted under the PWC such as the removal of subsidies contribute to the income-inequality. The overwhelming focus on other policies without sufficient protection of safety nets weakens the government and undermines the program's agenda.

2.1.4. IMF's "2018 Review of Program Design and Conditionality (ROC)"

The ROC conducted by IMF in 2018 was the first comprehensive review since the Global Financial Crisis of 2007-08. It aims to assess the extent to which program achieve the overarching goal of resolving balance of payment problems, medium term external viability, and fostering economic growth. Due to the growing criticism, the IMF team reviewed the performance and conditions associated with the programs from September 2011 to 2017. The underlying reason is the criticism that IMF offers uniform policies that are not adequately tailored to each country's circumstances. Some of the key findings are as follows:

- Growth optimism: Program assumptions for growth appeared too optimistic. It was contended to improvise the scrutiny of baseline assumptions, discussion of risk scenarios, and improve contingency planning in program design. Exploring reforms to modernize the review-based monetary policy conditionality framework was also supported.
- Quality of fiscal adjustment: The review focused more on the quality of fiscal adjustments such as capital spending floors or revenue targets to help improve the quality, composition, and growth orientation of fiscal adjustment. It was also stressed to retain sufficient flexibility, evaluate the country's implementation capacity, and take a case-by-case approach.
- Public debt: IMF agreed to reduce the bias in judgment on debt sustainability and to carefully assess case-by-case the debt operations and cost-benefit analysis of debt operations of each country.
- Structural conditionality: It was underlined that rather than increasing the number of structural conditions, the reforms should be subjected to the identified structural gaps.
- Ownership: Strengthening of institutional and political capacity was encouraged whereas staff was called off to consider ways to de-stigmatize staff-monitored programs.
- Tailoring and Uniformity of Treatment. It was acknowledged that Fund-supported programs are generally well-tailored to the country's needs and consistent with the principle of uniformity. However, it was acknowledged that the scope for further tailoring the program for fragile and small states is in light of their economic circumstances and capacity constraints is inevitable.

2.2. Existing Conditionalities/ Policies

The IMF has largely abandoned the Post-Washington Consensus and headed towards a narrower policy framework. The table below lists the current policies followed by the IMF.

Table 4: Existing IMF Conditions

S.No.	Current Policies	Explanation
1.	Fiscal Discipline	Shifting the focus to growth-enhancing investments such as education, health and infrastructure by cutting inefficient energy subsidies.
2.	Tax Reforms	Increased tax rates, improve tax collection, and reforming indirect taxes especially VAT to maintain fiscal sustainability.
3.	State Owned Enterprises	Ensuring the SOEs are efficient, transparent, and managed prudently.
4.	Central Bank Independence (CBI)	Insulating Central Bank from political interference and protecting loan disbursement from government abuse.
5.	Monetary Policy	Tightened monetary policy to curb inflation.
6.	Flexible Exchange Rate	To reduce imports and increase sufficient foreign reserves to pay off its debt including the newly borrowed IMF's debt.
7.	Capital Restrictions	Ease capital control measures to enhance investment and foreign earnings.
8.	Social Safety Nets	Increased social spending to protect the vulnerable from economic shocks and reforms.

2.2.1. IMF and Central Bank Independence (CBI)

There has been a widespread debate over the IMF's firm position in the favor of Central Bank Independence (CBI). Over the years, two quite different viewpoints of central banks have emerged. The first school of thought considers the country's central bank as the operational arm of government financial policies and argues that monetary policy should complement fiscal policy. Contrary to this, the other school of thought promotes the central bank's independence on the pretext that it will allow the central bank to implement monetary policy without interference from the government and will ensure price stability effectively (Tucker, 2020). In the recent scenario, the viability of Central Bank Independence came again under great scrutiny in the wake of COVID-19.

Generally, central bank independence encompasses three spheres: (i) independence of its board members, (ii) financial autonomy, and (iii) independence in devising policies. Although the first two spheres of independence have been accepted globally at large, however, independence of policies has been contested in many countries on various occasions.

Historical evidence however suggests that the monetary policy can not yield desired results when undertaken in isolation. The coordinated response of monetary and fiscal policies notably during the Great Inflation (the 1970s), the Global Financial Crisis (2007-08), and more recently during the COVID-19 pandemic appeared effective in combating crisis-induced economic vulnerabilities. In addition, the use of conventional monetary policy tools is ineffective in containing inflation which is induced by supply-side disruptions in developing countries rather they push countries into indebtedness and stagflation. Furthermore, an independent central bank may simply impose its preferences on society and may have an adverse impact (Lopes, 2012).

Major Critique on Central Bank's Autonomy

Limited or no impact of CBI in improving economic growth has also been urged in the literature (Samimi et al., 2010, & Alesina, 2013). The monetary policy cannot yield the desired result in isolation from the fiscal policy as monetary policy has consequences on the fiscal side of the economy. The major criticism of the Central Bank's autonomy are as follows

- The restricted government borrowing from the central bank leads to the crowding-out effect due to the reduced availability of loanable funds for the private sector (Alagidede, 2016).
- Weak monetary policy transmission hinders curtailing demand, however, raises debt servicing due to the weak bargaining power of the government as the government is not left with any other alternative for deficit funding.
- Independent monetary policy weakens the effectiveness of fiscal policy, especially for highly indebted countries such as Pakistan. The monetary-fiscal nexus is crucial during rapid inflation, especially in those countries where the central bank's role encompasses broader objectives (Hussain, 2006; Sims, 2016).
- The central bank's independence constraints the fiscal policy and raises income inequality. The government actions to curb inflation and minimize the impact on common people such as social protection programs are not sufficient enough. The highly levered economies get trapped in the vicious circle of poverty (Sims, 2016; M Aklin, 2021).

- They tend to be more secretive and less transparent (Mishkin, 2004 & Hussain, 2006). The central banks promote commercial banks' profitability rather than other objectives. Many times their operations and monetary policy actions are unexpectedly resulting in a shock to the economy.[6]
- Monetary policy with weak transmission channels hinders yielding desired results, however, raises debt servicing thus broadening fiscal deficit. The fiscal deficit then is covered by higher taxes, lowering subsidies and hikes in energy prices which suffocates the economy further.

2.2.2. IMF Quota Structure

The IMF loans are determined by quota denominated in Special Drawing Rights (SDRs) assigned to each of the IMF member countries. Quotas are crucial in classifying the subscriptions for creditors and the access to finance for debtors. Besides being used as an assessment tool for the member's relative position, the quota is also a measure of voting rights in the IMF decisions. The largest quota has been assigned to the US with SDR 83 billion (about US$ 118 billion) i.e. 17.43 % as of 2021. Pakistan's current allocation under the IMF Quota is 0.43%.[7]

Quotas are reviewed after every regular interval (not more than five years). Any change in quota must be agreed upon by 85 percent majority of the total voting rights in IMF. Historically, quotas were set according to the economy's size but now the measurement of quota is devised on the basis of the following equation:

$$\text{IMF Quota} = (0.50^* \text{ GDP} + 0.30^* \text{ Openness} + 0.15^* \text{ Variability} + 0.05^* \text{ Reserves})^{\text{compression factor}}$$

Where GDP is a weighted average GDP (based on market exchange rates) with 60% weight whereas 40% weightage is given on GDP based on PPP. 'Openness' is the average of the sum of current account payments and receipts for five years. 'Variability' measures vulnerability in the balance of payments and indicates the country's probability of approaching IMF in the future. 'Reserves' represents an average of official reserves (Foreign exchange reserves, gold, SDR holdings, and the country's position in the Fund) over the last twelve months. The compression factor of 0.95 has been included to reduce the dispersion in the calculation.[8]

2.2.3 Program's Assessment Criteria

IMF financing programs are often linked with demonstrable policy actions. If the country fails to follow these conditions, the institution can suspend or cancel its installments. In addition, strict sanctions can be imposed on the country in case of default on debt repayments. Moreover, all the rich-country donors (such as Britain and France) consider IMF programs and compliance with its conditions as a signal to offer their bilateral aid to countries seeking financial assistance. For the achievement and evaluation of defined goals under the program, the following measures are adopted:

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[6]https://www.bloomberg.com/quicktake/central-bank-independence
https://www.managementstudyguide.com/central-banks-be-independent.htm
[7]https://www.imf.org/en/About/executive-board/members-quotas#3
[8]https://www.imf.org/external/np/pp/eng/2015/061915.pdf
https://www.imf.org/external/np/spr/glossary.pdf

i. ***Prior Actions:*** Countries seeking the IMF program are required to undertake certain actions prior to the agreement and installments. For instance, the Finance Supplementary Bill, SBP Amendment Bill, and Electricity Tariff hike in the case of Pakistan under the 22nd IMF Program.

ii. ***Quantitative Performance Criteria (QPCs):*** QPC entails the quantitative conditions for the variables which are under the control of authorities including monetary and credit aggregates, fiscal balances, international reserves, and external borrowing. Restrictions on the net international reserves, general government borrowing from the SBP, and ceiling on government borrowing were the QPCs under the Sixth Review of Pakistan.

iii. ***Indicative Targets (ITs):*** These are also measurable indicators used to evaluate the successful implementation of the program. Examples of ITs include the minimum level of targeted cash transfer spending through BISP, the minimum level of the issuance of PIBs, Sukuks and Eurobonds, and others.

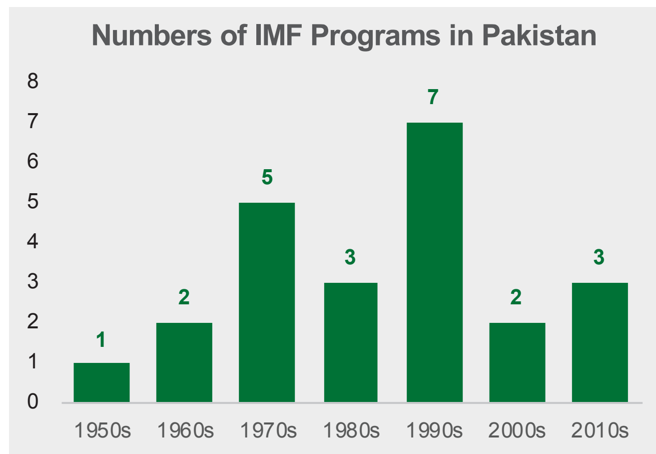
iv. ***Structural Benchmarks (SBs):*** These cover non-quantifiable measures of achieving goals and proper implementation of the program. Examples of SBs are transparency during COVID-19 procurement contracts, audit of COVID-19-related medical supplies, and Utility Stores Corporation (USC).

3. Pakistan's Historical Engagements with the IMF

Pakistan remained among one of the most prolonged users[9] of IMF resources and has been under IMF-supported programs almost continuously. In a span of sixty-four years, Pakistan has entered into 23 IMF programs – the highest among the South Asian countries. Specifically, Pakistan pursued Standby Arrangement (SBA)[10] 13 times, an Extended Credit Facility (ECF)[11]: 3 times, Extended Fund Facility (EFF)[12] 6 times, and sought a Rapid Financing Instrument (RFI) for the first time amid the COVID-19 pandemic.

3.1. Historical Background

Pakistan's history of entering IMF loans can be traced back to 1958 and the country emerged as one of the prolonged users of the IMF programs. In December 1958, Pakistan signed the first Standby Agreement to receive Special Drawing Rights (SDR) 25 million however it did not withdraw funds. The country become reliant on the IMF and has sought programs repetitively. It entered into two consecutive IMF programs in 1965 and 1968, withdrawing an amount worth SDR 112 million.



Amid the fall of East Pakistan in 1971, a political meltdown hit hard the country's economy. The incumbent government went to IMF programs four times in the span of just five years, i.e. 1972-1977, withdrawing a total of SDR 314 million. The successive government turned twice to the IMF in 1980 and 1981 securing a total amount worth SDR 1.08 billion.

The 1990s period is considered to be "the Lost Decade" being the most turbulent period in Pakistan's economic history. The power struggle between two democratic parties and a military coup consequently led to five political transitions in the span of just twelve years. It was the same period when Pakistan entered a record number of IMF programs withdrawing a total amount worth SDR 1.634 billion in a course of nine years.

Pakistan entered into three IMF Programs (2001, 2004 and 2008) during the first decade of the 21st Century. Due to the Global Financial Crisis along with increasing exogenous price shock and political transition, Pakistan entered IMF's SBA program with the highest amount worth USD 7.6 billion (500 percent of the quota) in 2008. The IMF's relationship with Pakistan remained unique from the 2000 to 2004 period since all the sixteen reviews during this period by IMF were completed by implementing the suggested conditions and the whole lending amount was drawn timely without any interruption (Hussain, 2010). The new political regime in 2013 sought another IMF program to avoid the economic crisis amid twin deficits and entered a three-year EFF IMF program with an amount worth USD 6.64 Billion (425 percent of the quota). The table below summarizes the IMF programs which Pakistan has taken so far and the reasons behind them:

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[9]Prolonged users appear to face external circumstances and have fiscal characteristics that are less conducive to swift adjustment. These include lower trend export growth and more volatile terms of trade, as well as more rigid structure of government expenditure, lower tax revenues, and a higher public debt burden.
[10]https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/33/Stand-By-Arrangement
[11]https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/04/Extended-Credit-Facility
[12]https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/56/Extended-Fund-Facility

Table 5: Reasons for Repetitive IMF Engagements

S.No.	Facility ('000s SDR)	Date of Arrangement	Expiration Date Drawn	Amount
23	Rapid Financing Instrument	16/04/2020	20/04/2020	1,015,500
22	Extended Fund Facility	03/07/2019	30/06/2023	3,038,000
21	Extended Fund Facility	04/09/2013	30/09/2016	4,393,000
20	Standby Arrangement	24/11/2008	30/09/2011	4,936,035
19	Extended Credit Facility	06/12/2001	05/12/2004	861,420
18	Standby Arrangement	29/11/2000	30/09/2001	465,000
17	Extended Fund Facility	20/10/1997	19/10/2000	113,740
16	Extended Credit Facility	20/10/1997	19/10/2000	265,370
15	Standby Arrangement	13/12/1995	30/09/1997	294,690
14	Extended Credit Facility	22/02/1994	13/12/1995	172,200
13	Extended Fund Facility	22/02/1994	04/12/1995	123,200
12	Standby Arrangement	16/09/1993	22/02/1994	88,000
11	Structural Adjustment Facility Commitment	28/12/1988	27/12/1991	382,410
10	Standby Arrangement	28/12/1988	30/11/1990	194,480
9	Extended Fund Facility	02/12/1981	23/11/1983	730,000
8	Extended Fund Facility	24/11/1980	01/12/1981	349,000
7	Standby Arrangement	09/03/1977	08/03/1978	80,000
6	Standby Arrangement	11/11/1974	10/11/1975	75,000
5	Standby Arrangement	11/08/1973	10/08/1974	75,000
4	Standby Arrangement	18/05/1972	17/05/1973	84,000
3	Standby Arrangement	17/10/1968	16/10/1969	75,000
2	Standby Arrangement	16/03/1965	15/03/1966	37,500
1	Standby Arrangement	08/12/1958	22/09/1959	0
	Total Amount Drawn			**17,848,545**

Source: International Monetary Fund (As of 30 Sep 2022) [13]

3.2. Key economic Indicators with and without IMF Programs

IMF Programs come up with internal reforms that IMF economists think will restore stability and growth. However, macroeconomic indicators reflect massive deterioration during the IMF programs and the program appears redundant in fostering sustainable economic growth for Pakistan. The table below provides an average of key economic indicators with and without IMF Programs. It can be observed that most of the macroeconomic indicators tend to deteriorate while undergoing programs (as highlighted in red). For instance, both average real GDP growth and industrial growth are lower in years while undergoing IMF programs. Similarly, inflation, interest rates, and unemployment rates are considerably higher during IMF programs than otherwise.

[13] https://www.imf.org/external/np/fin/tad/extarr2.aspx?memberKey1=760&date1key=2022-09-30

Table 6: Pakistan with and without IMF

Indicators	Average for years while undergoing IMF Programs	Average for years without IMF Programs
Industrial Growth (Real)	4.41	6.68
Real Gross Domestic Product Growth	4.09	5.53
Revenue Balance (% of GDP)	-1.71	-0.71
Fiscal Balance (% of GDP)	-5.91	-6.34
Primary Balance (% of GDP)	-1.13	-2.95
Tax Revenue (% of GDP)	11.35	11.37
Total Revenue (% of GDP)	14.53	14.53
Development Expenditure (% of GDP)	4.42	6.07
Total Expenditure (% of GDP)	20.63	21.26
Interest rate (Discount Rate)	10.94	9.38
USD/PKR (% change)	6.68	6.08
Current account balance (% of GDP)	-1.91	-3.95
Trade (% of GDP)	30.81	30.70
Inflation Rate	8.33	7.26
Total reserves (% of total external debt)	15.19	15.52
Unemployment Rate	5.50	4.61

Source: Multiple Sources

Data for all variables except the unemployment rate were used over the period 1976-2021
*Data for the unemployment rate was available only for the period 1983-2021

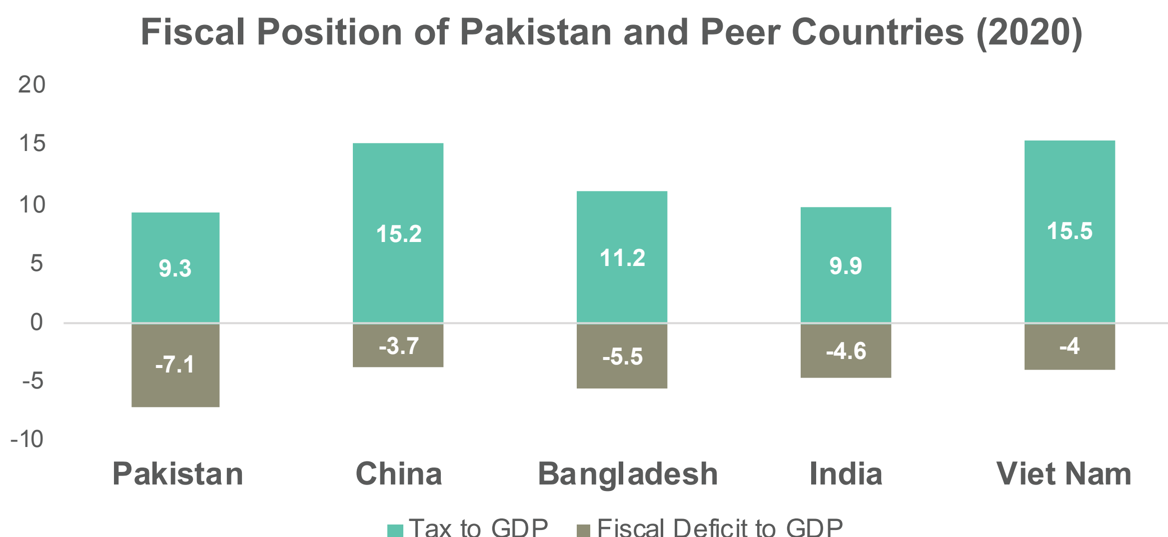
3.3. Reasons for Pakistan's Repetitive IMF Programs

Pakistan is the most IMF- addicted country in the region as it has sought the highest number of IMF programs as compared to other South Asian economies. Bangladesh, Srilanka, and India have only entered 12, 16, and 7 IMF programs respectively since their membership whereas Pakistan has so far entered into 23 IMF programs. China never sought any of the IMF programs. The core reasons for repetitive engagements with IMF are as follows:

- ***Poor Management of Fiscal Resources.*** Pakistan's tax-to-GDP ratio of 10% is lower than that of China, Bangladesh and Vietnam with excessive reliance on indirect taxes. Similarly, a fiscal deficit of 7.1% as a percentage of GDP in Pakistan is also substantially higher than the South Asian average as well as in comparison with peer countries including China, India, Bangladesh, and Vietnam as presented in the figure below.

Public sector expenditures on the other hand are dominated by current expenditures including debt servicing, subsidies, pensions, and others. In addition, a substantial increase in current expenditures compelled fiscal managers to cut development expenditures.

Figure 3: Fiscal Position of Selected Asian Countries

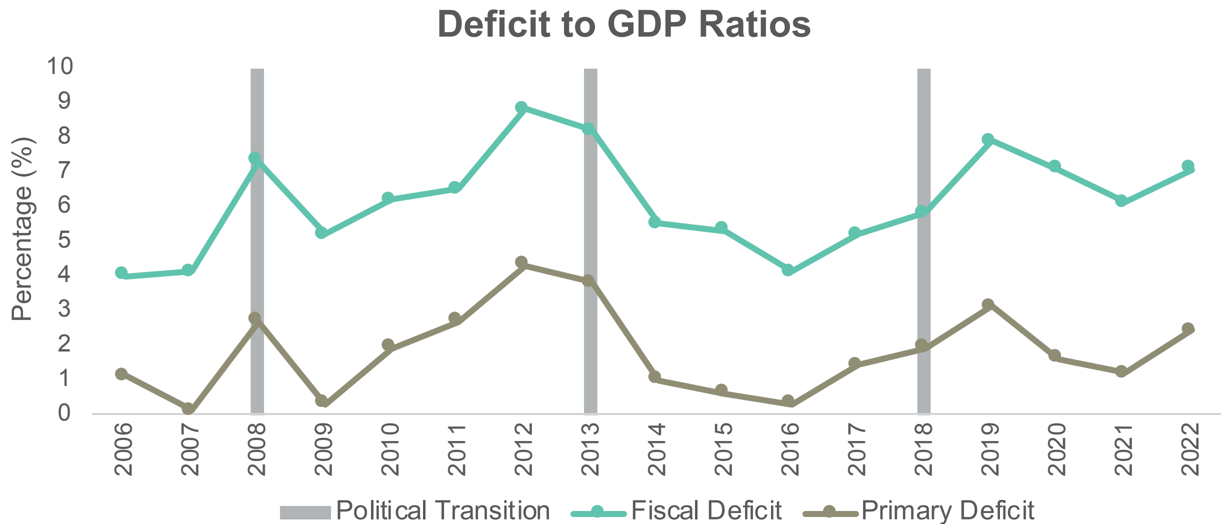


Source: World Bank, multiple sources

- **Massive Current Account Deficits.** Pakistan's imports have witnessed unprecedented growth since FY2004. Imports have increased almost five times from US$ 17.7 billion in FY2004 to around US$ 84.1 billion in FY2022. Exports growth has not matched the rampant imports, it posted a sluggish growth with an export value of US$ 15.1 billion in FY2004 now increased to around US$ 39.4 billion in FY2022. The current account deficit due to widening trade deficits has compelled the government to knock on IMF doors on multiple occasions.

- **Rent-Seeking Political Economy.** The political economy of Pakistan presents an embedded culture of rent-seeking and political patronage. The political system grants profits to certain players of the economy unfairly which impedes fair competition and the wrong set of incentives for businesses. For instance, Khwaja and Mian (2005) argue that politically connected firms in Pakistan get more loans from government banks despite having 50 percent higher default rates. In addition, politically motivated sub-optimal economic decisions such as artificially maintaining the exchange rate, rolling out petroleum as well as other subsidies, and other such measures significantly deteriorate both fiscal and current account balances along with other macroeconomic indicators. The figure below reflects that deficit-to-GDP ratios were significantly higher in the years near the political transition.

Figure 4: Deficit to GDP Ratios in Pakistan



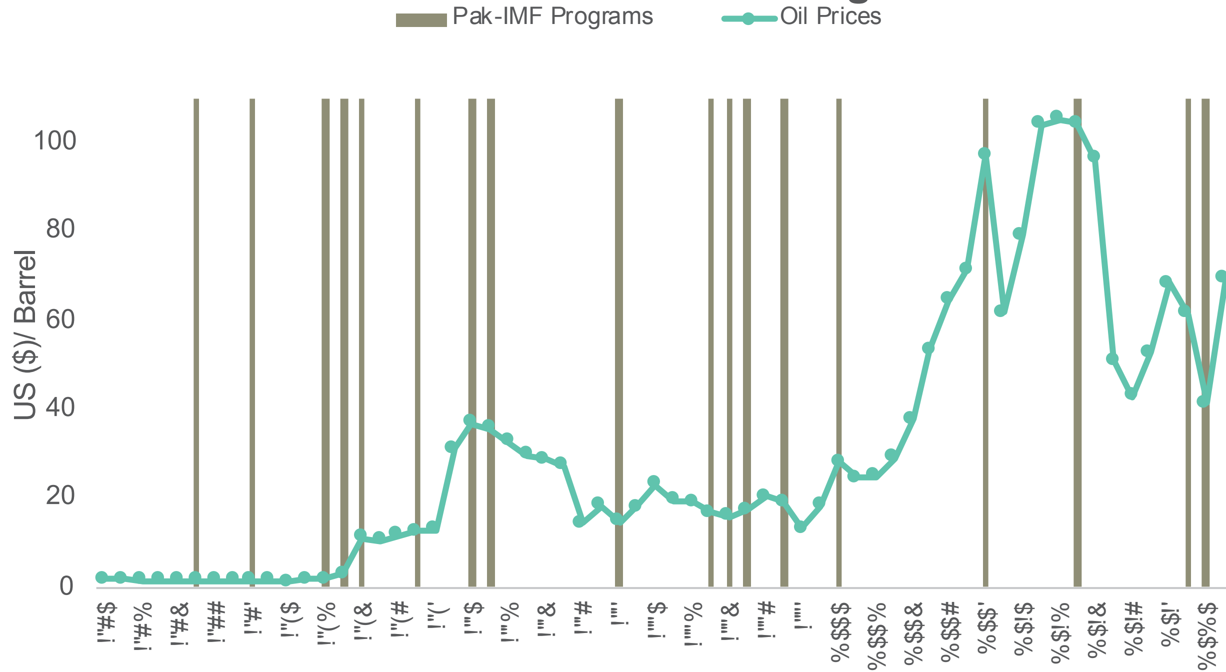
Source: Pakistan Economic Survey (PES) and Budget in Briefs

Note: 2022 figure from Budgets

- **Import-Driven Energy Policy.** An import-driven energy policy is not sustainable for Pakistan. Besides putting the entire economy at risk through inflation, it is a drain on foreign exchange reserves which exposes the economy to international energy price shocks.

  Historically, there seems to be a correlation between global oil price shocks and Pakistan's pursuance of IMF programs. It sought at least 15 out of 23 programs so far during the global surge in oil prices. Pakistan adopted three consecutive IMF programs during the 1970s Oil Crisis in 1972, 1973, and 1974. Another wave of global oil price shocks amid the Iranian Revolution compelled Pakistan to knock on IMF doors again in 1980. A similar trend can be observed with other IMF programs and more recently in 2008 (amid Global Financial Crisis), 2013, and 2019.

  In addition, energy sector reforms in the 1990s prescribed by the donor agencies back-fired and further threatened energy security. For instance, government guarantees large capacity at an upfront tariff of US cents 6.4/unit based on imported furnace oil, abandoned by the rest of the world after the oil embargo of the 1970s. The policy has added 16 furnace oil and gas-based Independent Power Producers (IPPs) to the system. As a consequence, the country's economic security is now at the mercy of the oil price cycle as during the period of high oil prices import value of furnace oil increases which erodes the reserves significantly and leads the country to seek another IMF program.



Source: IMF and World Bank

- **Flawed Designs for IMF-Supported Programs.** Most of the IMF-supported programs were based on overly optimistic projections for factors such as GDP and export growth. Projections on macroeconomic variables by IMF implicitly assume that the program will be implemented in the true spirit which is clearly not the case in Pakistan. In addition, maintaining a positive real interest rate to control inflation appears counterproductive. Similarly, debt sustainability targets were most of the time missed.

4. Pakistan's 22nd IMF Program

Pakistan entered into the 22nd bailout program in July 2019, that is, the Extended Fund Facility (EFF) which was initially worth US$ 6 billion (i.e. 210 percent of the quota) at a markup rate of 3.2 percent interest rate[14]. After introducing some key adjustments and supplementary bills in 2019 and early 2020, the program was put on hold after its first review in April 2020 due to the COVID-19 outbreak. The EFF program aimed at reducing economic vulnerabilities in Pakistan and stabilizing growth. In the post-pandemic period, the program was resumed in April 2021 after a combined 3rd,4th, and 5th review. The sixth review took place after Pakistan reiterated its commitment to the program while meeting a series of stiff conditions such as setting autonomous SBP, revenue measures in supplementary finance bill including enhancement of petroleum development levy, and others. However, domestic political turmoil and the break out of the Russia-Ukraine War (hike in commodity prices & higher energy prices) have significantly deteriorated both fiscal and external accounts. After Pakistan's recommitment to better fiscal discipline, seventh and eighth reviews occurred which increased the overall access of the fund to US$ 6.5 billion and the tenure of the EFF program further by 09 months ending in FY23.

4.1. Major Prescription of the 22nd IMF Program and their Effectiveness

The 22nd IMF program is more focused on structural adjustments. The EFF program aimed at reducing economic vulnerabilities in Pakistan and stabilizing growth. The following key objectives were set under the program:

i. Fiscal Consolidation

The IMF prescribed certain measures for fiscal consolidation under each review. During the 22nd program, the fund conducted so far eight reviews (till the report goes to press) and recommended the following fiscal consolidation measures to help curb the fiscal deficit.

Table 7: Fiscal Measures under the 22nd IMF Program

Fiscal Measures	
1st Review (Dec-2019)	1. Electricity Tariff Adjustment for Capacity Payments 2. No Tax Amnesties 3. Reduction of certain exemptions and preferential tax rates 4. Enhancing the sales tax on petroleum products 5. Rationalize income tax credits and incentives
2nd-5th Review (Apr-2021)	1. Significant hike in the electricity prices 2. Imposition of Rs. 140 billion taxes.[15]
6th Review & Article IV (Feb-2022)	1. Increase in Petroleum Development Levy by Rs. 8 with the commitment to gradual increase till it reaches Rs. 30. 2. Finance Supplementary Bill (GST Reform) of Rs. 343 Billion[16,17]

[14] https://www.arabnews.pk/node/1501976/pakistan
[15] https://tribune.com.pk/story/2291237/imf-programme-back-on-track
[16] https://www.dawn.com/news/1669331
[17] https://www.dawn.com/news/1673007

Fiscal Measures	
7th & 8th Review	1. Personal Income Tax Reform in budget FY23. 2. MoU between Federal and provinces for consistent fiscal targets for FY23 3. Reversal of Relief Package (subsidy on power sector), by hiking the PDL on Diesel/Petrol (Rs.5/10) with the gradual increase in PDL to Rs. 50. 4. Hiking prices of the power sector in a bid to restore energy sector viability

Source: International Monetary Fund (IMF) and others

Despite recommended fiscal consolidation measures under the IMF program, fiscal ratios deteriorated further.

- ***Fiscal Deficit***. The 22nd IMF program contended to reduce the fiscal deficit as a percentage of GDP by 3-4 percent till FY23 from 7.1 percent in 2019-20. Although it decreased to 6.1 percent in 2020-21 but again increased to 7.1 percent in 2021-22.
- ***Debt-to-GDP.*** The IMF's prescription to curb debt also appears futile. It follows a similar trend as it first decreased to 71.5 percent in 2020-21 but increased to 73.5 percent in 2021-22.
- ***Tax-to-GDP.*** The fund projected the tax-to-GDP to increase by 4-5% till FY2024, however, it declined to 9 percent in 2021-22.

Table 8: Fiscal Indicators

Fiscal Indicators (% of GDP)	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22*
Overall Fiscal Deficit	5.2	5.8	7.9	7.1	6.1	7.1
Total Revenue	13.9	13.3	11.2	13.2	12.4	11.0
Tax Revenue	10.4	10.8	9.7	9.3	9.4	9.0
Public Debt	60.2	63.7	74.7	76.6	71.5	73.5

Source Pakistan Economic Survey, Federal Budget and SBP

**2021-22 values are Revised Estimates Budget FY23*

ii. Improving the safety nets (Establishing a social-assistance program)

Improving safety nets for the most vulnerable segments of the economy includes the Ehsas Program, Benazir Income Support Program (BISP), and Waseela-e-Taleem (WeT) to protect them from the direct influence of adjustment policies made under the IMF program. Pakistan has made major strides in improving safety nets with the introduction of target subsidies. But double-digit inflation seems to nullify any favorable impact of these measures.

iii. Flexible Market-Determined Exchange rate.

IMF stresses countries adopt flexible market-determined exchange rate regime on a grounds that it allows a greater degree of monetary policy autonomy, provide buffers against external shocks, improve the trade competitiveness of the country consequently, and improves the export-to-import ratio. Both fixed exchange rate and market-based flexible exchange rate regimes however failed to yield desired results in the case of Pakistan. Due to the ongoing IMF program, the current market-based flexible exchange rate regime also could not improve the export-import ratio however triggering high exchange rate volatility only. The table below reflects that the export-import ratio during 2022 was 0.45 which is similar to the ratio (0.44) prevailing in FY2018 when the fixed exchange rate regime was prevailing.

Table 9: Impact of Exchange Rate

Fiscal Year	Exchange Rate Volatility*	Exports-to-Imports Ratio	Depreciation (YoY) (%)	Exports Growth (%)	Imports Growth (%)	FX Reserves (in Bn $)
2017	0.11	0.39	0.25	-1.86	18.38	21.40
2018	4.79	0.38	16.09	13.78	14.92	16.38
2019	9.23	0.42	34.00	-1.09	-9.92	14.48
2020	3.77	0.48	2.50	-6.81	-18.64	18.89
2021	4.90	0.45	-5.78	18.28	26.55	24.40
2022	12.24	0.40	29.82	25.60	42.14	15.45

*Source: IMF and SBP, *Measured by (Standard Deviation)*

Given the continuous depreciation of the exchange rate in accordance with the free-floating market regime, external debt poses a major threat. The rupee declined by more than 30 percent in FY22 declining from USD/PKR 157.6 in June 2021 to USD/PKR 204.8 in June 2022. Currency depreciation has caused an increase in the total public debt by Rs. 3.8 trillion in FY22 alone.

iv. Monetary Policy to Contain Inflation

To cope with inflation, IMF recommends raising the interest rates. However, policy rates as a tool to control inflation appear redundant in the case of Pakistan. The country is experiencing supply-side inflation due to the global commodity price hike and measures such as the adoption of a flexible exchange rate regime as suggested by the IMF.

National statistics provided in the table below reflect that despite the higher policy rates, inflation has increased over the last couple of years while increasing interest payments on debt.

Table 10: Public Debt- Component Wise Breakup

Component Wise Break-Up of Increase in Total Public Debt				PKR in Billion
	2019-20	2020-21	2021-22	Total Change
Total Public Debt	3,689	3,461	9,326	16,476
Financing of Federal Primary Deficit	982	967	2,428	4,377
Interest on Debt	2,620	2,750	3,182	8,552
Currency Depreciation	399	-665	3,764	3,498
Others	-312	409	-49	48
Inflation (%)	10.8	8.8	12.1	-
Policy Rates (Average, %)	11.8	7.0	9.7	-

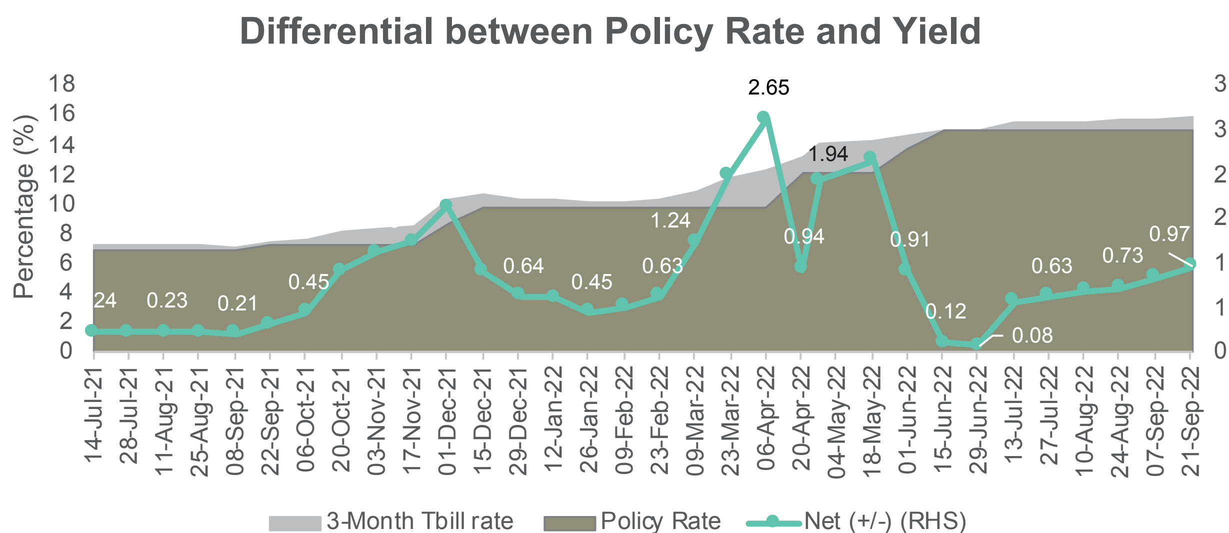
Source: DPCO, Ministry of Finance

v. Autonomy of the State Bank of Pakistan

The program entails ensuring the autonomy of the State Bank of Pakistan (SBP) in its operational and administrative functions. Along with other amendments through SBP Amendment Act, 2021, a bar on government borrowing has been placed. It has increased the government's reliance on commercial banks to finance its fiscal deficit. The government's share in the credit portfolio of the scheduled bank has increased from 61.3 percent in June 2019 to 65.9 percent in June 2022[18].

As a consequence, already limited access to finance to the private sector has been reduced further. In addition, the government's dependency on commercial banks to finance its deficit has weakened its bargaining position. The differential between the policy rate and the T-bill rate (03 months) was around 0.24% in the T-Bill auctions in July 2021 which reached 2.65 percent in Sep 2022 reflecting the weaker bargaining position of the government.

Figure 5: Impact on Yield Rates



Source: State Bank of Pakistan (SBP), Pakistan Bureau of Statistics (PBS)

[18]State Bank of Pakistan

The State Bank's autonomy is aimed at the promotion of financial stability removing policy-making under the purview of political cycles and consolidating the financial system. However, the measures such as the prohibition of borrowing by the central government have weakened the borrowing power of the government which has raised the financing costs substantially.

The State Bank of Pakistan Amendment Act, 2021

The main constituents of the bill are restructuring monetary objectives, eliminating government borrowing, discontinuation of the Monetary and Fiscal Coordination Board, and immunity for key officials of SBP from NAB inquiries. The federal cabinet has approved the State Bank of Pakistan Amendment Act 2021 which advocates greater autonomy for the SBP. The key changes in the act are as follows:

- **Objectives.** Achieving and maintaining domestic price stability has been set as a primary objective of the State Bank of Pakistan. It identifies price stability and financial stability as primary and secondary objectives respectively whereas its tertiary objective is to support the government's economic policies.

- **Mobilization of Financial Resources.** The following amendments have been made to provide sufficient resources to the bank to fulfill its objectives.

- SBP Profits. Distribution of SBP profits is no longer required prior approval from the government.
- Share Capital. The Authorized Capital has been increased from the previous threshold of one hundred million rupees to five hundred million rupees.
- Sufficient Capital and Reserves. Paid-up capital and general reserves have been increased to 8% of SBP's monetary liabilities by retaining 20% of the shared profits each year.
- Recapitalization. In case of a reserve falling below zero, the Federal Government would transfer the required amount in cash or negotiable instruments upon the bank's report.

- **Functional and Institutional Autonomy.**

- Government Borrowing. The State Bank is no longer liable to lend to the federal government for covering the fiscal imbalances of the country.
- Quasi-Fiscal Operations. SBP has been granted financial and institutional autonomy. The SBP will not continue to make any quasi-fiscal operations on behalf of the government including rural credit and export credit. However, the concessional schemes will be continued.
- Co-Ordination Mechanism. The monetary and Fiscal Policies Coordination Board (MFPCB) has been abolished. Instead, the Governor and Finance Minister will establish a close liaison to inform each other about matters concerning the two institutions.

- **Administrative Autonomy**

- Terms of Office. The terms of the Directors, Members, and Governor have been extended to five years.

- **Improved Transparency**

- Executive Committee. For the decisions related to core matters, the Executive Committee has been established comprising of Governor, Deputy Governors, Executive Directors, and other officers. However, Voting Rights have been only given to Governor and Deputy Governor.
- Audit Committee. The audit committee will be constituted by the Board comprising three or more Non-Executive Board Members
- External Audit. The external audit auditors will be appointed by the Audit Committee rather than by Board.

vi. Address the Energy Sector's Structural Weaknesses

To adjust the energy sector's structural weakness, IMF provided certain adjustments to rationalize the tariffs including measures such as a hike in tariff rates, charging quarterly tariff adjustments, and adaptation of a circular debt reduction plan. Multiple measures under the IMF program were taken to improve the efficiency of the energy sector by rationalizing the cost of the power sector and subsidies to reduce the circular debt of the sector. Overall, the conditions of circular debt in Pakistan worsened even during the IMF program. The size of the circular debt of the power sector has increased to Rs 2.25 trillion in June 2022 from Rs. 1.148 trillion in FY18.

vii. Structural Reforms

The program has an agenda for structural weaknesses impeding Pakistan to reach its full potential through better governance. One of the core reform agendas includes the reduction of losses due to State Owned Enterprises (SOEs) by introducing privatization and greater transparency. However, the net budgetary impact of SOEs as a % of the budget deficit has increased from 19.7 percent in 2019-20 to 46.2 percent in 2021-22.

Table 11: Budgetary Impact of SOEs

Amount in Billion	2017-18	2018-19	2019-20	2020-21	2021-22
A. Revenue from SOEs	**210.0**	**181.6**	**85.1**	**115.3**	**160.3**
Interest Payments	130.0	121.0	36.9	75.0	90.0
Dividends	80.0	60.6	48.2	40.3	70.3
B. Cost of SOEs	**345.7**	**487.3**	**704.3**	**798.5**	**1741.4**
Contingent Liabilities	195.0	210.0	302.5	323.0	269.4
Grants to Railway & PSM	38.5	37.0	45.0	40.0	47.0
Subsidies	108.0	214.2	317.0	377.4	1394.0
WAPDA/ PEPCO	81.5	189.9	211.0	350.4	989.0
Petroleum	-	-	47.0	12.0	377.0
TCP	5.0	-	-	-	-
PASSCO	17.5	18.3	15.5	7.0	7.0
Utility Store Corporation	4.0	6.0	43.5	8.0	21.0
Loans	4.2	26.1	33.3	58.2	31.0
PIA	0.0	19.6	27.2	19.5	20.0
Steel Mills	4.2	6.5	6.1	38.7	11.0
Others	-	-	6.5	-	-
Equity in CPPA	-	-	6.5	-	-
C. Net Budgetary Impact	**135.7**	**305.7**	**619.2**	**683.2**	**1581.1**
% of Budget Deficit	9.2	16.2	19.7	21.4	46.2
% of GDP	0.4	0.8	1.5	1.5	2.4

Source: Budget in Briefs of Various Issues, Pasha (2021)

viii. Improving Anti-Money Laundering (AML)/ Combating Financing of Terrorism (CFT) framework.

Enhanced anti-money laundering framework will establish a conducive environment for private businesses and job creation. In this regard, IMF used FATF's action plan as the performance criteria with Pakistan gradually improving its compliance with FATF. Pakistan successfully implemented all the 27 points given under the FATF's action plan and is no longer in FATF's grey list accordingly.

4.2. Conditionalities under 7th, 8th & 9th IMF Reviews

The table below discusses the prior actions and structural benchmarks and their economic implications under the 7th & 8th reviews. In addition, prior conditions for the completion of the 9th review have also been discussed which is still in discussion before this report went to press.

Prior Actions	Economic Implications: 7th & 8th Review
1. FY23 Budget in line with IMF recommendations including Personal Income Tax Reforms	Incorporation of the PIT Reforms is a welcome development as it increases the progressivity of direct taxes and mobilizes additional revenues. This is in line with the FPCCI's budgetary proposal.
2. Provincial Governments signed an MoU on provincial fiscal targets to be consistent with the FY23 Budget	It will have positive implications for the economy and would pacify the federal government's excessive reliance on indirect taxes. Although MoU has been signed by provincial governments to generate a cash surplus worth Rs. 750 billion, however, a recent increase in current expenditures due to flood has made it highly unlikely for provinces to meet this target.
3. Relief Package Reversal and commitment to gradually increase Petroleum Development Levy (PDL) to Rs. 50 by January 2023	Rolling back of relief package was a prudent step as the oil price shock had hit the global economy. However, the increase in PDL has triggered inflation and eroded purchasing power significantly.
4. Increase in per unit cost in the power sector	In an attempt to reduce circular debt, the government has increased electricity tariffs. According to the latest reports, the circular debt has been increasing by Rs. 129 billion on an annual basis with the total circular debt of the energy swollen to Rs.4.2 trillion.[19] It has further stimulated inflation and contains adverse implications for the industries.
Structural Benchmarks	**Economic Implications: 7th & 8th Review**
1. Commit to not grant further tax amnesties.	Tax amnesties allow to channelize holdings (both in terms of USD as well as PKR) from lockers and personal safes into the bank account. In addition, schemes such as industrial amnesty help boost industrialization and aid economic growth. A bar on any further tax amnesties would limit the government's ability to mobilize revenues and foster economic growth.
2. Avoid the practice of issuing new preferential tax treatments or exemptions	The preferential tax treatments and exemptions create loopholes in the tax management system. According to a study by the Pakistan Business Council (2021), Pakistan loses about Rs. 600 billion each year due to tax evasion (smuggling), and misuse of concessionary duties. It is likely that government may stick to its commitment as it already has limited fiscal space available.
3. Preparation of draft personal income tax (PIT) legislation.	Measures recommended for the PIT legislation are remarkable and help increase the share of direct taxes in the national tax pool. The current PIT draft included in the FY23 budget achieves some objectives but is not completely in line with the Fund's advice.
4. Adoption of measures to strengthen the effectiveness of the AML/CFT.	Pakistan was removed from the FATF's Grey List due to the adoption of measures strengthening the effectiveness of AML/ CFT Laws. Adoption of such measures was a necessary action for bringing about international accreditation.
5. Preparation of a plan by the Ministry of Finance and State Bank of Pakistan, in consultation with other stakeholders, to establish an appropriate Development Finance Institution to support the eventual phasing out of SBP refinance facilities.	The establishment of a Development Finance Institution, that is, EXIM Bank is an appreciable step. However, a bar on SBP's subsidization to set up EXIM Bank would require the federal government to dedicate funds which already has a very narrow fiscal space. Moreover, the LTFF and the EFS schemes complement the manufacturing sector for technological advancements and export promotion.

[19]https://tribune.com.pk/story/2391025/circular-debt-soars-past-rs4177bn

Prior Actions	Economic Implications: 7th & 8th Review
6. Completion of the first-stage recapitalization of the two private sector banks that are undercapitalized.	The move will ensure the viability of the financial sector as both these banks[20] are highly undercapitalized based on capital adequacy ratios.
7. Parliamentary approval of new SOE law in line with staff recommendations	The new SOE law aims to define a rationale for state ownership, ensure commercially sound SOE operations, and regulate oversight and ownership arrangements. Contingent liabilities due to loss-making SOEs have increased to around 5-6% of GDP. Any effort to curtail such losses is welcoming and will help improve the fiscal outlook.
8. OGRA Act Amendments bill.	The government's role should be minimized in the regulation of prices as time and time again political decision-making supersedes economic rationality hurting the economy in the long run. Empowering OGRA for price regulation after forty days if the government does not regulate prices is a move in the right direction but due to the lower level of reserves, the period should be reduced further for effective implementation.
9. Establish a robust asset declaration system with a focus on high-level public officials	It will bring transparency and help channelize assets into the system.
10. Public Procurement Regulatory Authority (PPRA) Regulations	According to S.R.O 591(1)/2022, the bidding documents of the procuring company that is above Rs. 500,000/- shall be advertised. This measure shall assist in ensuring transparency and open competition.
New Structural Benchmarks	**Economic Implications: 7th & 8th Review**
1. Targeted increase of the BISP Kafalat beneficiary base to 9 million families using the NSER	Social protection concerns have been heightened due to the devastation caused by recent floods. Enhancing the coverage of the BISP program is welcoming and will help pacify economic miseries to some extent.
2. Finalization of the combined annual rebasing (AR) for FY22 and FY23 to take effect on October 1, 2022. 3. Submission to NEPRA of petitions for the (i) FY23-July FPA by end-August; and (ii) FY23-Q1 QTA by end-October which will ensure full recovery of the revenue requirement (including lost revenue from the delayed first-stage Annual Rebasing FYs22-23 in July 2022) within FY23Q2.	It indicates that more tariff hike in the shape of fuel price adjustments is already on cards. Multiple rounds of hikes in electricity prices have already fueled inflation and threatened the survival of industries. The business community discourages any such move.
4. Adoption of a comprehensive strategy to address high levels of NPLs in some banks, 5. Initiate orderly liquidation (resolution) of either or both of the two currently undercapitalized private sector banks by end-May 2023 should they remain undercapitalized at that point	The move will ensure the viability of the financial sector as both these banks[21] are highly undercapitalized based on capital adequacy ratios.

[20/21] Silk Bank and Summit Bank

Prior Actions	Economic Implications: 7th & 8th Review
6. Submission to Cabinet of amendments to align Pakistan's early intervention, bank resolution, and crisis management arrangements with international good practices,	It is imperative to safeguard financial stability and will help align the financial sector regulatory framework in line with international good practices.
7. Operationalization of a Central Monitoring Unit (CMU) within the Ministry of Finance.	Effective monitoring and surveillance of SOEs are crucial to mitigate the current level of losses on account of SOEs.
8. Publication of a comprehensive review of the anticorruption institutional framework (including the National Accountability Bureau)	It will aid the effectiveness of institutions pertaining to anticorruption and help improves transparency, accountability, and integrity of the public sector. The business community always appreciates such steps.
Prior Conditions	**Economic Implications: 9th Review**
1. Hike in interest rates	The interest rates were hiked by massive 300 basis points in March 2023 reaching a 27-year high rate of 20%. However, the policy rate as a tool to control inflation appears futile in Pakistan. Despite the episodic hike in the policy rates by 725 bps from 9.75% to 17% during January 2022 and January 2023, general inflation surged from 13% to 27.6% over the same period. This raises the question of policy rate efficacy in curbing inflation.
2. Permanent Power Debt Surcharge	A levy of Rs. 3.23 per unit debt surcharge for commercial & industrial consumers and Rs. 2.19 per unit for Agricultural consumers were made to cover Rs. 800 billion from the circular debt by FY2024. The surcharge will be continued beyond FY24. The permanent hike would fuel further inflation and would adversely impact the competitiveness of businesses.[22]
3. Market-Based Exchange Rate	The rupee which has been kept stable in the inter-bank market through administrative measures was again set to be controlled by the market forces.. Investigations by the State Bank found manipulations by market players. The rupee again followed the declining trend and depreciated further by 18% since then.
4. Finance (Supplementary) Bill, 2023	The Bill prescribed revenue measures worth Rs. 170 billion. However, the enhancement in sales tax rate from 17% to 18% would increase inflation and the regressive nature of indirect (sales) tax would hit hard the low-income class. Industries such as auto parts, tiles, paints, and cement would also be impacted. Few measures such as raise in taxes on cigarettes, sugar, sweetened drinks, and aerated water are though in line with the FPCCI's suggestions and WHO's recommendation. The increased minimum price cap for expensive cigarette brands from Rs. 6,600 to 9,000 should have been maintained to cover more revenues.
5. Social Protection Measure: Rs. 80 bn kept for the BISP	Out of Rs. 80 billion, Rs. 40 billion is allocated for additional social protection measures and the remaining will be kept for arrears. It is imperative to safeguard the vulnerable in society but this measure would not be sufficient enough to mitigate the effect of increased inflationary measures mentioned above given the loopholes and lower coverage.
6. Withdrawal of Power Subsidies to the Zero-Rated Industrial Sector and Agriculture tube wells (Kisaan Package)	The early withdrawal of the subsidies to the industrial sector in March upon IMF's condition which was supposed to be withdrawn in June 2023 will hurt the already declining exports. Moreover, the Rs. 3.60 per unit subsidies under the specialized 'Kisaan Package' has also been withdrawn which would worsen the flood-affected agriculture sector and exacerbate the food insecurity of Pakistan.

[22] https://tribune.com.pk/story/2403987/rs323-debt-surcharge-slapped

5. Empirical Assessment of The Effectiveness Of The Imf Program's

This chapter aims to analyze the efficacy of the IMF Programs and their impact on macroeconomic variables.

5.1. Data and Variables

The annual data of Pakistan over the period 1981 to 2020 is used to estimate the impact of IMF programs on macroeconomic variables. The dependent variables include GDP Growth, Fiscal Balance, Current Account Balance, Inflation, and Industry (value-added) growth whereas government revenues, credit to the private sector, public debt, exchange rate, electricity tariffs, inflation, interest rate, global oil prices and terms of trade are the independent variables. The table below describes a set of variables used in this study:

Table 12: Data and Variables

Variables	Description	Source
GDP Growth	The GDP growth rate is measured as a % change in GDP.	World Development Indicator, World Bank
Fiscal Balance	Fiscal Balance refers to the difference between national resources and expenditures. Measured in % of GDP.	State Bank of Pakistan
Current Account Balance	Current Account Balance (CAB) is the sum of net exports of goods and services and income. CAB is used as a % of GDP	World Development Indicators, World Bank
Inflation	Inflation as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly	World Development Indicators, World Bank
Industry (Value Added) Growth	Industry (Value-added) growth at a constant price is measured as a percentage change in consecutive years. It is used to measure the industrial output relative to the overall output.	World Development Indicator, World Bank
Government Revenue	Government Revenue is referred to as Tax and Non-Tax Revenues. It is taken as a % of GDP.	State Bank of Pakistan
Domestic credit to the private sector	Domestic credit to the private sector refers to financial resources provided to the private sector by financial corporations, it is taken as a % of GDP.	World Development Indicators, World Bank
Government Debt	Government Debt includes Domestic and External Debt, taken as a % of GDP.	State Bank of Pakistan
Exchange Rate	The exchange rate is the price of the Pakistani Rupee (PKR) in terms of US Dollars ($). Measured in Percentage Change.	International Financial Statistics, IMF
Electricity Tariff	Electricity Tariff is measured in US$ per kWh. Measured in Percentage Change.	NEPRA
Interest Rate	Central Bank Policy Rate (%)	International Financial Statistics, IMF
Global Oil Prices	Crude Oil Price is measured in US$ per Barrel	Pink Sheet, World Bank
Terms of Trade	Terms of Trade is the measured as the ratio of index export prices to index import prices. It is taken as a percentage change.	International Financial Statistics, IMF

5.2. Methodology

There is mounting evidence available in studies diagnosing the impact of IMF programs on macroeconomic indicators. Empirical studies such as Barro and Lee (2003), Haque and Khan (1998), and others evaluate the impact of IMF programs on different macroeconomic variables employing various sets of methodologies including a before-after (BA) approach, with-without approach, generalized evaluation estimator (GEE) and comparison of simulations (SIM) approach. Haque and Khan (1998) contend that studies implying before-after and with-without approaches do not yield favorable results in comparison with other approaches such as GEE. The Generalized Evaluation Estimator (GEE) compares the macroeconomic performance in the program and non-program years by adjusting for the exogenous shocks. GEE models assume that the target variables change to reflect changes in macroeconomic policies, changes in external factors, the impact of IMF during program years, and unobservable shock.

The model was first used by Goldstein and Montiel (1986) and later by Dicks et al. (2000) find that IMF Structural Adjustment Programs in 61 developing countries improved the growth and external debt situations whereas inflation remained insignificant. Hakro and Ahmed (2006) analyze IMF programs in Pakistan during 1973-2000 using the same methodology. Their study showed IMF has a significant and positive impact on inflation and Budget Balance. In the same vein, the GEE model used in this study takes the following form:

$$\begin{aligned}\Delta \text{Target Variable}_t &= \beta_0 + \beta_1 \text{ Target Variable}_{t-i} + \beta_2 \text{Govt. Revenue}_{t-i} \\ &+ \beta_3 \text{ Credit to Private Sector}_{t-i} + \beta_4 \text{Govt. Debt}_{t-i} + \beta_5 \text{ Exchange Rate}_{t-i} \\ &+ \beta_6 \text{ Electricity Tariff}_{t-i} + \beta_7 \text{ Interest Rate}_{t-i} \\ &+ \beta_8 \text{ IMF Dummy} + \beta_9 \text{ Global Oil Prices} + \beta_{10} \text{ Terms of Trade} + u_t\end{aligned}$$

Where the target variables include GDP growth, fiscal balance, current account balance, inflation, and industrial growth. Global oil prices and terms of trade have been kept as exogenous variables. The IMF Dummy takes the value of 1 if the program is in effect for at least four months in a year and 0 otherwise. The corresponding coefficient captures the impact of the IMF program during the observed period on target variables.

5.3. Empirical Results

In line with the empirical strategy discussed in the previous section, the findings of the model are as follows:

- **Economic Growth.** IMF programs tend to have a statistically negative impact on the GDP growth rate in Pakistan. It is found that it lowers the GDP by 0.94 percentage points annually, on average. Other factors that turn out to have a significant impact on GDP growth are as follows:

  - Other factors that are found significant in growth are revenue to GDP, interest rate, and terms of trade. The results indicate that a one percentage points increase in revenues (as % of GDP) causes economic growth by 0.40 percent to rise reflecting that the government with more fiscal space could increase economic activity.

  - Interest rates and terms of trade, on the other hand, decrease the GDP growth rate by 0.32 and 0.04 percentage points respectively. An increase in terms of trade reduces the competitiveness of exports and tends to decline the output (Singh, 2022). This could be because of a limited export base of developing countries and inelastic imports.[23]

- **Current Account Balance & Fiscal Balance.** The IMF program turned out positively and statistically significant in improving twin deficits. The fiscal deficit decreases by 0.88 percentage points (as % of GDP) on average in the presence of IMF programs. The current account deficit (as a % of GDP) decreases by 0.90 percentage points during IMF programs. Other factors having an impact on the current account balance and fiscal balance are as follows:

  - One percent increase in government revenues (as % of GDP) deteriorates the current account balance by 0.43%. A potential reason could be the greater share of customs duties and sales tax on imports in government revenues which increases with the increase in imports but deteriorates the current account deficit.
  - The current account balance improves with the depreciation of the local currency against the USD as exports become cheaper while imports become expensive. Particularly, the depreciation of PKR against USD by 1 percentage point improves the current account balance by 0.11 percentage points.
  - The fiscal balance improves by 0.46 percentage points for every one percentage point increase in revenues (% of GDP).

- **Inflation.** Results show no significant direct impact of IMF programs on inflation. However, debt, electricity tariffs, and global oil prices have a significant impact on inflation. The indirect impact of IMF programs in fueling inflation is through the following channels:

  - ***Electricity Tariffs.*** Specifically, for every one percent increase in electricity tariffs, inflation tends to increase by 0.31 percent. Electricity tariff hike is among the common tools used under the IMF programs to reduce the fiscal deficit which ultimately raises price levels. The weight for 'Electricity Charges' in Consumer Price Inflation (CPI) is around 4.6 percent.
  - ***Debt Management.*** One percent increase in debt-to-GDP induces inflation by 0.65 percentage points. IMF's bar on central bank lending to the government compelled governments to borrow expensive loans from commercial banks. The government relies more on indirect taxes in Pakistan for increasing revenues in order for servicing higher levels of debt. Indirect taxes such as sales tax are considered distortionary which also raises the price level.
  - ***Global Oil Prices.*** Global Inflation is also found to be positively related to global oil prices as an increase in oil price leads to a surge in commodity prices of domestic and imported items. Pakistan has a higher dependency on imported fuel (Malik, 2016).

- **Industrial Growth** is found to be negatively linked with the exchange rate indicating that Pakistan's industry is import dependent. Depreciation of local currency by one percentage point, on average, reduces industrial growth by 0.20 percentage points. Similarly, there exists a negative relationship between interest rates and industrial growth.

[23] https://cepr.org/voxeu/columns/lasting-effects-terms-trade-shocks-business-cycles

Table 13: Results of the GEE Model

Variables	Δ GDP Growth	Δ Fiscal Balance	Δ Current Account Balance	Δ Inflation	Δ Industry
Policy Variables					
GDP Growth $_{t-1}$	-1.08*	-	-	-	-
Fiscal Balance (% of GDP $_{t-1}$	-	-0.50*	-	-	-
Current Account Balance (% of GDP) $_{t-1}$	-	-	-0.22	-	-
Inflation $_{t-1}$	-	-	-	-0.10*	-
Industry Growth $_{t-1}$	-	-	-	-	-1.08*
Government Revenue (% of GDP) $_{t-1}$	0.41**	0.46**	-0.43**	2.16	0.61
Credit to Private Sector (% of GDP) $_{t-1}$	-0.01	0.08	0.04	-	-0.00
Debt (% of GDP) $_{t-1}$	-0.04	-0.01	-0.01	0.65*	-
Exchange Rate (% Change) $_{t-1}$	-0.01	-0.03	0.11*	-0.05	-0.20*
Electricity Tariff (% Change) $_{t-1}$	0.03	0.03	0.01	0.31***	-37.49
Interest Rate $_{t-1}$	-0.32*	-0.10	0.08	-0.15	-0.47**
Dummy Variable					
IMF	-0.95***	0.85**	1.35**	-5.62	-0.66
Exogenous Variables					
Global Oil Prices	-0.02	-0.02**	-0.02	0.35*	-0.01
Terms of Trade (% Change)	-0.04**	-0.03**	0.02	0.03	-0.04
Constant	7.22***	4.57	4.14	-88.87***	6.22
R-squared	0.69	0.47	0.61	0.59	0.76
Serial Correlation LM Test	0.24*	2.23*	0.08 *	4.61*	3.61*
Breusch-Pagan- Godfrey Hetero. Test	0.38*	2.29*	1.49*	0.32*	0.84*

Note: The estimates were computed through ordinary least squares (OLS). The standard errors were corrected using Huber-White standard errors.
* Significant at 1% level of significance, ** significant at 5%, and *** significant at 10%

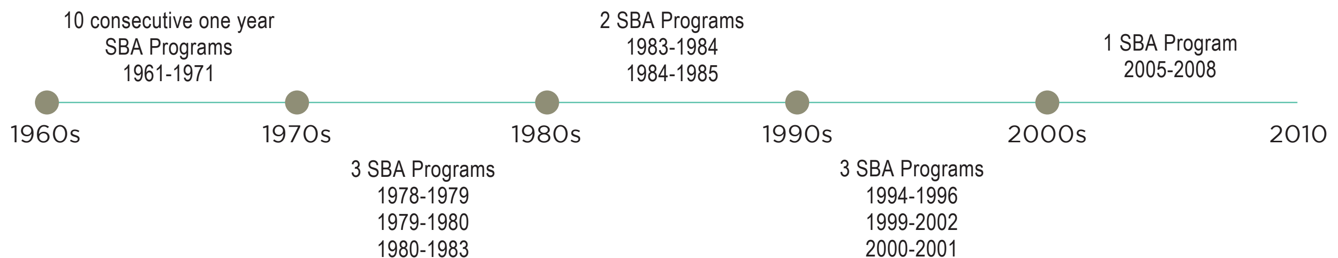
6. Country Case Studies

Case studies for countries can be distinguished among countries that graduated from IMF programs by implementing a home-grown model and those who became IMF dependent and have been prolonged users of IMF programs. This chapter selectively discusses the two case studies of countries that successfully implemented 'home-grown' models including Turkiye and Indonesia, as well as two case studies of prolonged users of IMF programs namely Ghana and Sri Lanka.

- **TÜRKIYE**

  Turkiye has been a member of the IMF since 1947 and has so far sought 19 IMF programs. The very first program was undertaken in 1961. Most of the IMF programs were pursued during the military regime due to an acute shortage of foreign currency and high inflation[24]. The major reason for consecutive engagement with IMF during the 90s was the political uncertainty and lack of governance (Koch, Chaudhary, & Bilquees, 2002). Successive coalition governments lacked the incentive and capability to undertake any reform in the economy. The following timeline exhibits the IMF bailout programs in Turkiye since its inception.

Figure 6: Timeline of IMF programs in Turkiye



In 2001, Turkiye experienced a meltdown of financial markets which triggered the banking crisis. IMF prescribed raising the interest rates by 4.5 times which put the country into the worse recession[25]. During 2002-2007, the Turkish government took multiple economic reforms.

Some of the major reforms that the Turkish government pursued to avoid pursuing IMF programs further are as follows:

- ***Privatization of SOEs and Localization of Energy Resources.*** The foremost reform adopted was to privatize loss-making State-Owned Enterprises including Telecommunications, Energy, Sugar and Tobacco sectors resulting in an unprecedented inflow of Foreign Direct Investment (FDI). The proceeds from the privatization were invested in huge infrastructure projects to reduce its energy dependency on imported resources. These projects mainly include two nuclear power plants and others with locally produced brown coal, investment in its gas infrastructure (shale gas deposits), and liberalization of gas and electricity markets (competitive electricity model).

[24]https://www.dailysabah.com/columns/cemil-ertem/2018/03/21/when-the-imf-dominated-turkey-and-the-current-facts
[25]https://www.tepav.org.tr/upload/files/haber/1253189328r3541.Turkeys_Renaissance_From_Banking_Crisis_to_Economic_Revival.pdf

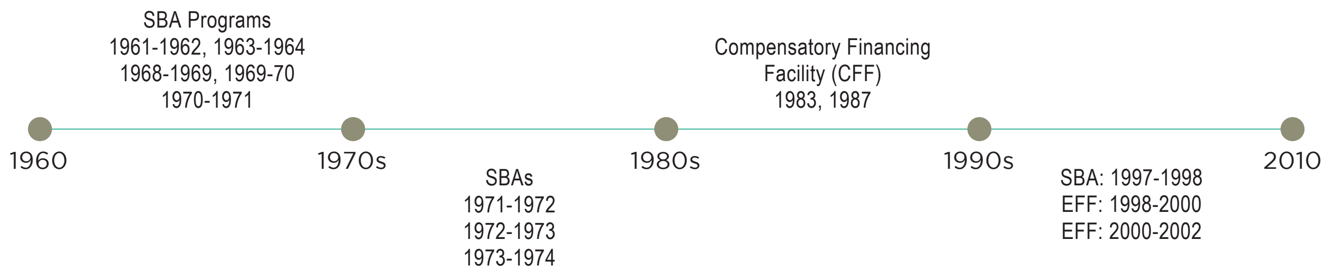
- Rationalization of Corporate Taxes. In order to attract investments, the Turkish government reduced the then corporate tax rate substantially from 30 percent to 20 percent. It also tightened its fiscal expenditures by cutting public expenditures such as salaries and subsidies.
- Public Procurement Law (PPL). Public Procurement Law was also passed in 2002 to address various anomalies in the public procurement system. Most of the public agencies such as the public housing agency ('TOKi') were brought under the law. The law aimed to enhance competitiveness and end corruption through well-planned and well-defined procurement processes monitored by the Public Procurement Authority.
- Agricultural Law 2006. Traditional instruments such as input subsidies and minimum support prices supporting the agriculture sector were abolished and replaced by targeted subsidies. The government announced direct income support for farmers to reduce distortions in the market. The law also defined arrangements for research and development in Agriculture Sector.
- Tightened Banking Regulations. To restore the investor's confidence, Turkiye also restructured its banking system which proved to be successful in avoiding 2008's global financial crisis. A tightened regulatory framework was introduced to encourage apolitical lending practices to avoid a banking crisis in Turkiye as was in 2001. An independent and professional board was established for major banks in Turkiye.
- Trade Reforms. Turkiye stressed increasing its export. It successfully diversified its export markets from 90 countries to more than 130 countries during the reform period (World Bank, 2014). They targeted the Middle Eastern and North African countries for their agro-based exports and focused on the exports of medium-tech products (automotive and chemicals) in the growing EU markets. The number of trade advisors in the importing countries tripled in the period of 2002-2007. SMEs turned out to be the engine of Turkish export growth due to improved access to finance. 'TURQUALITY' as a national brand is also one of the success stories of the Turkish export-led growth agenda.

a. INDONESIA

Indonesia has so far sought 13 IMF programs since the 1980s. It received the biggest IMF loans in terms of value during the Asian Financial Crisis 1997/98 due to huge currency depreciation and massive capital flight. The country emerged as the most affected country due to the crisis when it entered the IMF program. At times, it was classified as a severely indebted country by the World Bank as the debt-to-GDP ratio reached 100 percent of the GDP. The macroeconomic targets were ambitious, the capital flows remained at the same level, and the debt crisis still prevailed during the program[26]. The Indonesian government then decided to stall the program in 2002 as IMF already had meddled a lot in the policy-making. In a short span of five years, the country became able to not only survive the Global Financial Crisis of 2007-09 but highest economic growth among Asian economies (World Bank, 2010).

[26]https://www.imf.org/external/np/ieo/2003/cac/pdf/all.pdf

Figure 7: Timeline of IMF programs in Indonesia



Source: IMF, Chowdhury, and Sugema (2005)[27]

Some of the major reforms which the Indonesian government pursued to avoid pursuing IMF programs are as follows:

- ***Debt Restructuring.*** One of the prime reasons for the economic collapse was short-term external borrowing. Since 2004, the Indonesian government tilted its debt portfolio more towards domestic borrowing and from short-term borrowing to long-term borrowing. Government securities dominated in local currency were issued reducing the financial risk[28].
- ***Big-Bang Decentralization Program.*** The fiscal devolution to local governments was successfully implemented in the post-IMF scenario. Expenditures including salaries and running costs were decentralized to the local governments with the big bang decentralization program. Other than the general and specific grants from the central government (based on needs), around 26% of the federal revenues driven from fuels were also transferred to the local governments.
- ***Fiscal Reforms.*** The debt-to-GDP ratio of Indonesia reached around 100% in 1999 which was reduced to around 25% in 2007 amid the stringent set of reforms implemented by the fiscal managers. Resources mobilization shifted the composition towards non-oil and gas revenues. This has not only increased revenues but also reduced dependence on volatile oil and gas receipts. Improved tax administration remained a key milestone in the reforms, especially for personal income tax revenues.[29]
- ***Other Corrective Measures.*** Indonesia adopted a combination of monetary and macro-prudential policies to maintain its foreign exchange reserves.

i. Development expenditures were cut significantly to support the lower levels of revenues and high debt payments.

ii. The Central Bank of Indonesia has operational independence, however, for monetary policy's effectiveness, the coordination between the central bank and the Ministry of Finance was strengthened in 2005 under the Formal Inflation Targeting Framework[30].

iii. In wake of capital outflows, immediate capital restrictions were imposed to control further outflow which was inconsistent with the IMF program then.

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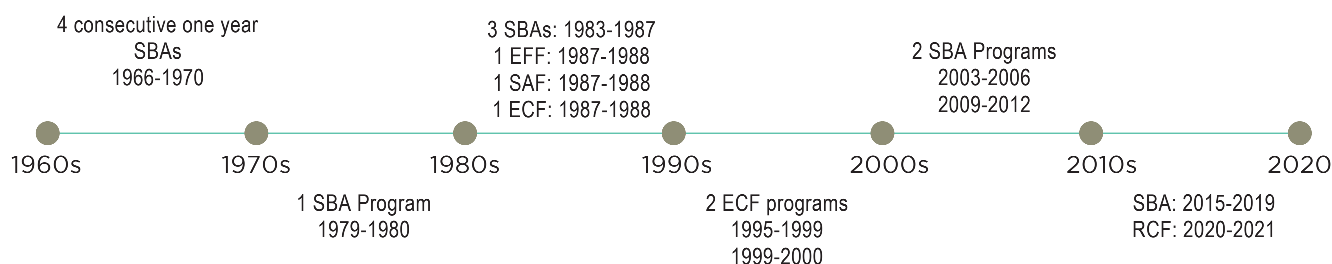
[27] https://intercafe.ipb.ac.id/wp-content/uploads/2010/12/2.-How-Significant-and-Effective-Has-Foreign-Aid-to-Indonesia-Been.pdf
[28] https://www.bis.org/publ/bppdf/bispap67n.pdf
[29] https://www.oecd.org/gov/budgeting/45362389.pdf
[30] https://www.oecd.org/indonesia/38275859.pdf

b. GHANA

It is widely argued that the IMF policies during the 1980s and 1990s yield a negative impact on African economies and societies in developing countries, especially in African Countries. Ghana struggled with decades of immense political instability and drought after the overthrow of the then government which was further triggered by the global oil crisis. In 2001, the country was identified as a 'highly indebted poor country' with high inflation, rapid exchange rate depreciation, and low reserves due to high debt servicing. Ghana which was once considered the IMF success story in Africa during the 2000s however borrowed a whopping $602 million in 2009 again just two years after exiting from the IMF's Poverty and Reduction Growth Fund (PRGF) in 2006.

Figure 8: Timeline of IMF programs in Ghana



The macroeconomic conditions of Ghana started worsening in 2012. The economic growth subdued from 8 percent in 2012 to 3.5 percent in 2015. The fiscal deficit remained in double digits for two consecutive years. The three key issues that led Ghana to another IMF bailout program were large fiscal expansion (through wage increases), currency depreciation (by 20% during 2012-14) and the energy crisis. Ghana then signed a three-year $918 million EFF in 2015 which was later extended to 2019 aiming to restore macroeconomic and debt sustainability. Apparently, the inflation was controlled to single-digit and other variables showed notable improvement before plunging again into a debt crisis and falling back into the habit of turning to the IMF again. The decline in commodity prices and the non-productive use of loans had pushed Ghana into a debt crisis.[31]

The major set of measures that the IMF prescribed to Ghana in the latest program are as follows:

- ***Fiscal Consolidation***. The 2015 Budget embraced huge fiscal adjustments to restore growth and debt sustainability. The ceilings on other expenses such as wages, subsidies (to utilities and the petroleum sector), and transfers were cut as per IMF's directions which resulted in a reduced public deficit (7.5% of GDP in 2019).
- ***Revenue Measures***. The increased VAT threshold and rate from 12.5% to 15% were set as prior actions of the IMF program. Other than these, new taxes were imposed such as Petroleum Tax, and previous taxes were raised. In addition, the tax exemptions for State-owned Enterprises and free zone companies were eliminated in 2016. Despite such measures, revenues were increased over a short span but could not be sustained.

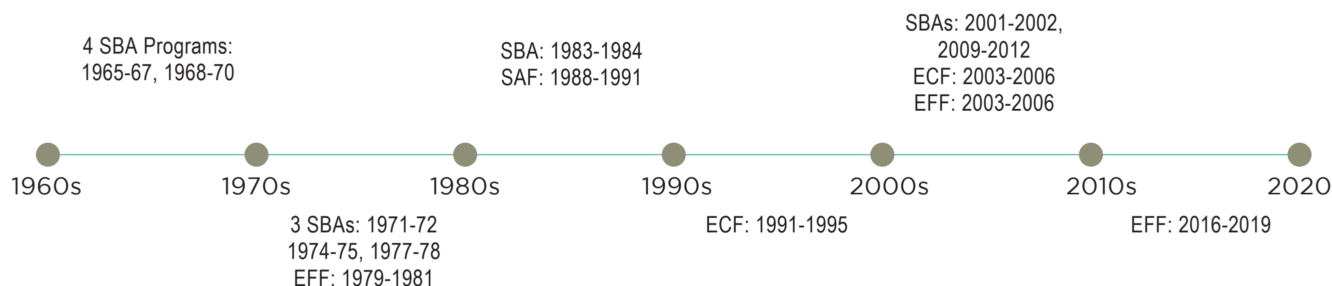
[31]https://jubileedebt.org.uk/wp-content/uploads/2016/10/The-fall-and-rise-of-Ghanas-debt_Executive Summary_10.16.pdf

- ***Wage Bill***. The wage bill was the single largest expenditure of the government since 2009 which reached 11.4% of the GDP in 2012 (World Bank, 2017). Under IMF conditions, Public employees who were suspended, under investigation, or without any bank account were removed from the payroll. The new federal recruitment and increment on existing payroll were restricted. Biometric verification and audit of the payroll became mandatory.
- ***Supervision of State Owner Enterprises***. The IMF along with the World Bank attempted to regulate and improve the governance of the loss-making SOEs through the Economic Management Strengthening project. The restructuring of SOEs was financed through issuing bonds such as 'energy bonds' for the energy sector. A new entity for monitoring SOEs was established by law. Despite the efforts, the SOEs remain precarious.
- ***Fiscal Responsibility Act, 2018***. Ghana has suffered greatly from fiscal volatility, especially during election cycles. To overcome this, a new law "Fiscal Responsibility Act, 2018" was passed to govern government spending giving the authority to the parliament to monitor spending trends and its limits. Moreover, the law stipulated that the overall annual fiscal deficit must not exceed five percent of the GDP. Secondly, the government's primary balance must be in surplus. The law has been suspended by the succeeding government in Ghana.
- ***Debt Management***. Under IMF conditions, the Economic Policy Coordination Committee (EPCC) was re-established to strengthen the coordination between the Ministry of Finance and the Bank of Ghana, under which a separate sub-committee was devoted to debt and finance. The debt structure was shifted to long-term debts with floating rates but remained a meager share of the overall debt composition. Ghana might have shown progress under initial phases but fall again on the same paths. Ghana still stands at the highest debt ratio and has reached 82% in 2021 and according to IMF estimates would reach 84.6% in 2022.
- ***Central Bank Independence and Banking Sector Reforms***. The reform aimed at strengthening the central bank by ending the lending to the federal government and public institutions. The IMF conditions also include setting up a mechanism for emergency lending of the central bank to commercial and other banks. Ghana developed new regulations to ensure banks follow credibility standards to avoid non-performing loans.
- ***Flexible Exchange Rate***. Strictly implemented a market-based exchange rate regime. However, the country has been facing exchange rate volatility in 2019. Since the adoption of the flexible exchange rate, the Cedi has depreciated against major other currencies as well.

c. SRI LANKA

Sri Lanka has undergone 16 IMF programs including the last and recent IMF program initiated in 2016 which was extended till 2019. Sri Lanka is characterized by a persistent current account deficit, and weaker FDI inflows combined with capital outflows which have contributed substantially to declining foreign reserves. The largest loan Sri Lanka borrowed was during the SBA program in 2009 worth USD 2.5 billion. In the Sri Lankan borrowing history, the lending arrangement agreed upon was not fully disbursed at least seven times. The most recent one is the last IMF program which was prematurely terminated in 2018 due to terrorist attacks and political crises. The recent IMF assistance became inevitable due to three main reasons: immediate current account balance, unlocking other financings (bilateral and multilateral loans), and restoring the confidence of private investors.

Figure 9: Timeline of IMF programs in Ghana



The major set of measures that the IMF prescribed to Sri Lanka in the latest program are as follows:

- ***Tax Measures***. The measures targeted amendments in Inland Revenue Acts by removing tax exemptions to broaden the tax base and increased taxes on dividends and capital gain. VAT Audits expanded to all sectors and the rate increased from 11 to 15% in 2016. The tax exemptions were eliminated on telecommunication and private health care.
- ***Active Liability Management Act (ALMA)***. To improve public debt management, ALMA was passed in 2018 as IMF's structural benchmark restricting the federal government from borrowing exceeding Rs. 300 billion.[32]
- ***Energy Pricing Reforms***. An automatic fuel pricing mechanism for both electricity and fuel was introduced along with the changed pricing formula to eliminate subsidies and protect fuel tax revenues completely. However, it was overshadowed by higher oil prices and foreign exchange depreciation. The measure fueled inflation in the economy.
- ***Managing State-Owned Enterprises***. In order to strengthen the transparency and compliance of SOEs, the submission of bi-annual compliance reports through Statements of Corporate Intent (SCI) to the Supreme Court was made mandatory. The strategic plan for restructuring Sri Lankan Airlines was under discussion but could not implement due to the termination of the program.
- ***Monetary Policy Stance***. The Monetary Law Act was passed in 2018 in which price stability was established as the Central Bank of Sri Lanka's (CBSL) primary objective. The autonomy of the central bank was ensured and a bar on quasi-fiscal activities was placed. The tight monetary policy stance was maintained in the initial years of the program to control inflation. Moreover, the reserve requirement was raised and macro-prudential instruments (credit limit and increased weight on the housing sector) were utilized in curbing inflation.
- ***Flexible Exchange Rate.*** A flexible exchange rate was adopted as a tool for a monetary mechanism allowing the government to intervene through the market in case of excess volatility. Amid depleting reserves, the capital outflow restrictions were removed which were temporarily introduced by the Sri Lankan government.

Case studies discussed above reveal that these countries started engagements with IMF during the 1960s, however, more tailored domestic reforms adopted by Turkiye and Indonesia have allowed countries to come out from the economic crisis and avoided any further pursuance of IMF programs. On the other hand, Ghana and Sri Lanka despite embracing generic prescriptions dictated by the IMF are facing major economic overhauls.

[32]https://www.cbsl.gov.lk/en/news/the-parliament-of-sri-lanka-passes-the-resolution-to-raise-rs-310-billion-by-way-of-loans

7. Conclusion and Policy Recommendations

6.1. Conclusions

Elite capture in Pakistan has brought the economy to a perennial state of collapse. Respective governments in Pakistan have failed to avoid IMF assistance and have continued seeking temporary relief rather than focusing on structural changes. The absolute autonomy of the Central Bank has also made Pakistan subservient to the IMF. Repetitive programs have achieved no lasting solution for the country as most of the macroeconomic indicators deteriorated while undergoing the IMF programs. The one-size-fits-all approach of IMF is not tailored to address the root cause of the economic problem. The adjustment programs have never been sustained to the extent that the economy can lead to a self-sustaining growth path. The economic reforms proposed under the 22nd IMF deal are similar but more stringent than the previous set of policies in the previous agreement which already had failed to produce desired results.

The key findings of the report are as follows:

- Empirical findings of the study reveal that the adverse impact of the IMF program on most of the macroeconomic indicators however it curbed the twin deficits significantly.
- IMF prescriptions ignore socioeconomic outcomes and measures such as the removal of subsidies tend to aggravate income inequality. In addition, multiple rounds of exchange rate depreciation trigger the cosh-push inflation and the sharp increase in interest rates further deteriorates the country's monetary outlook.
- Macroeconomic indicators during IMF programs reflect deterioration as compared to periods without IMF programs. For instance, average industrial growth and GDP growth were lowered by 2.27 and 1.44 percentage points respectively while Pakistan underwent IMF programs.
- Poor management of fiscal resources, massive current account deficits, and a rent-seeking political economy have been the major reasons for Pakistan being a prolonged user of IMF programs.
- Countries that successfully graduated from IMF programs such as Turkiye and Indonesia have adopted structural reforms along with fiscal expansion while relying less on monetary and exchange policy mechanisms.
- The adoption of a flexible exchange rate regime failed to enhance the export-to-import ratio while fueling inflation and increasing volatility.

6.2. Policy Recommendations

A pragmatic approach needs to be taken to pull the economy out of the crisis. The set of proposed reforms for the 'Home Grown' model as an alternative to IMF programs are as follows:

6.2.1. De-Politicize Economic Decision Makings

Political-point scoring on economic issues and avoiding unpopular economic decisions have deprived the country to reach its economic potential. To disentangle the economy from the heat of the political crisis, it is urged that a widespread consensus among all political parties and relevant stakeholders must be made on the 'Charter of Economy'.

6.2.2. Measures Pertaining to Fiscal Management

Proposed measures to cut fiscal deficits are as follows:

(i) **Solving Intricacy of Tax Regime.** The number of tax payments should be reduced and the level of automation should be enhanced on a priority basis. According to estimates by the Pakistan Institute of Development Economics (PIDE, 2020)[33], businesses bear on average Rs. 250,000 for tax compliance in 2019. This could also shift the reliance from indirect taxes to direct taxes in the country.

(ii) **Targeted and Direct Subsidies/Transfers.** The country needs to phase out subsidies to non-productive sectors and subsidies should be limited for a certain pre-specified period. Fuel subsidies must be replaced with direct transfers. Under the current subsidy regime, even rich households get subsidized rates.[34]

(iii) **Development Projects.** The ongoing development projects must be prioritized over projects that are at the initial stage. Early completion of ongoing projects would help increase the productive capacity of the economy in the long term and completion of such projects may help in raising revenues.

(iv) **Devolution of Expenditure under the NFC.** The 7th National Finance Commission (NFC) Award in 2009 handed over 57.5 percent of the federal resources to provincial governments with a view to enabling provinces to take up the extra burden. While the resource transfer was immediate, the federal government failed to fully devolve a load of subjects in a similar fashion.

Aligning the expenditure and revenue assignments by either devolving expenditures assignments to provinces or reducing the vertical share of provinces is recommended.

(v) **State Owned Enterprises (SOEs).** The loss-making SOEs must be turned into commercially viable businesses either via privatization or through public-private partnerships. The net budgetary impact of SOEs has reached around Rs. 1,581 billion (or 46.2 percent of the budget deficit) in FY2022.

(vi) **Big Bang Decentralization.** Global evidence reflects that the decentralization of revenue as well as administrative responsibilities to the local tier of government contributed to fiscal consolidation. Article 140A of the Constitution of Pakistan identifies the local government as the legal third tier of the governance structure.

It is recommended to implement 'Big Bang' decentralization similar to Indonesia in order to curb the crippling fiscal deficit.

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[33] https://pide.org.pk/pdfpideresearch/rr-036-growth-inclusive-tax-policy-a-reform-proposal.pdf
[34] https://www.dawn.com/news/1691755

(vii) Fiscal-Monetary Coordination. The State Bank of Pakistan's (SBP) approach to tame inflation by increasing the policy rate turned out futile and has adversely impacted the government's balance sheet due to the higher cost of debt servicing.

An assessment of the likely impact of monetary policy should be made before levering any of the monetary policy tools.

(viii) Restore Lending Facility from the State Bank. The government's excessive reliance on commercial banks to finance its deficit reduces the bargaining position and has increased the cost of borrowing. It is recommended to remove the bar for lending from the central bank at least for a certain pre-specified period.

6.2.3. Energy Sector Reforms

Pakistan has an energy mix with 40% of electricity being produced by renewable sources. It needs to shift from imported furnace oil to affordable and indigenous sources of electricity production (such as Thar coal) to reduce import bills. Turkiye adopted a similar energy indigenization strategy in an attempt to remain away from IMF programs.

6.2.4. Debt Management

Proposed measures for debt management are as follows:

(i) Prudence in Debt Management Policy. Pakistan could have avoided around 38% of the cost of debt servicing in 2018-19 and around 27% in 2019-20 by adopting a prudent debt strategy (Pasha, 2021).

A prudent debt management strategy must be maintained. Long-term debt instruments should be given additional weightage when the inflation is single-digit and short-term loans if inflation is double-digit to safeguard from any adverse lock-in effects.

(ii) Rationalizing Debt Servicing. While implementing the amended FRDLA (2022), the following steps should be followed for rationalizing existing debt:

- The government should first come up with a plan to reduce the debt-to-GDP ratio to sustainable levels in line with the FRDLA.
- Negotiations with external lenders should be initiated for debt rescheduling and restructuring.
- The central bank must be urged to maintain low benchmark interest rates and rely on alternative monetary policy tools for containing inflation.
- The government, being a primary borrower, should be offered loans on fixed but lower interest rates.

(iii) Developing Bond Markets. Domestic borrowing in Pakistan is dominated by a handful of commercial banks. It is imperative to set up well functioning secondary bond market.

Providing access of the government bond market to the corporate sector as well as for other financial institutions such as mutual funds would also increase the competition among domestic lenders and rationalize the cost of debt.

6.2.5. Stabilizing External Accounts

The following measures are recommended to restrain the external deficit of the country:

(i) **Export Diversification.** Pakistan has a limited export base (mainly textiles and agro-based) for which exports are concentrated in only a few markets. Stressing export diversification by exploring potential markets such as Africa and Central Asia either through FTAs or PTAs is inevitable. During the reform period, Turkiye successfully diversified export markets from 90 countries to more than 130 countries.

(ii) **Non-Tariff Measures to Curtail Imports.** Pakistan has been using import tariffs as a principal instrument for protection and import substitution. Higher tariffs do protect local businesses but act as an implicit export tax. For products with inelastic demand, increased tariffs only trigger inflation.

Embargoes on imports of luxury consumer goods along with higher cash margins should be imposed. Measures such as the enhancement of tariff-rate quotas, minimum import prices, and others should also be adopted.[35]

(iii) **Foreign Exchange Management.** Measures for foreign exchange management are as follows:

- Restrictions on foreign travel for leisure should be imposed during periods of low reserves. International travel for tourism purposes should only be allowed once in every three years.
- Harnessing digitalization potential would help accelerate remittance inflow. New innovative remittance solutions such as mobile payment and international digital wallets should be introduced. Efficient global payment channels such as Remitly, PayPal, and others may be invited as well as Pakistani FinTech should collaborate with international counterparts.
- Similar to the Philippines and other peer countries, facilitating investment by the diaspora in the real estate and industrial sector by providing tax breaks and linking up loans and saving products with remittances may also be considered.
- Cash incentives and a separate rate for remittances that is higher than the interbank exchange rate should be offered. Such policies worked well in Bangladesh and Sri Lanka.
- Non-Resident Pakistani bonds should be introduced to attract dollar inflows. India raised US$ 32 billion in three issues during 1991, 1998, and 2000[36]. Similar success stories can be observed in the case of Nigeria and Israel.

[35]https://www.geo.tv/latest/421112-balance-of-payment-crises-tough-decisions-not-stop-gap-measures-need-of-the-hour
[36]https://blogs.adb.org/blog/asia-could-use-diaspora-bonds-finance-development

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Appendix

The Generalized Evaluation Estimator equation can be represented in a simpler form:

$$Y_i = \beta_1 + \beta_2 X_i + \beta_3 W_i + \beta^{IMF} D + \varepsilon \quad \text{——— (i)}$$

Where Y is the target variable at time t (i.e. GDP growth, Fiscal Balance, Current Account Balance, Inflation, and Industry Growth), Xi is the policy instrument(s) used by the authorities to achieve desirable macroeconomic objectives during IMF programs (government revenues, credit to the private sector, public debt, exchange rate, electricity tariffs, inflation, interest rate), Wi includes the exogenous variables accounting for the effect of external changes (global oil prices and terms of trade). β IMF measures the effect of the IMF Dummy Variable.

The model assumes that the policy reaction links the changes in the macroeconomic policy variable to the deviation of the lagged target variable from the desired value, which can be described as follows:

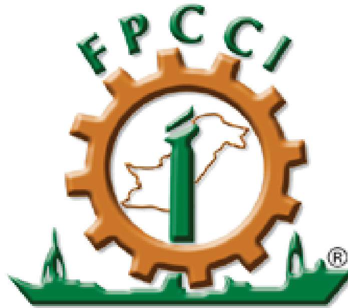
$$\Delta X_i = \delta_0 (Y1^d - Y_{t-1}) + \eta \quad \text{——— (ii)}$$

Where Δ is the adjustment factor, Y1d is the desired value, η is the random shock and Δ is the first difference operator. After the substitution of equation (ii) in equation (i), the reduced form of the generalized evaluation estimator equation (GEE) becomes:

$$\Delta Y_i = \beta_0 + \beta_1 Y_{t-i} + \beta_2 X_{t-i} + \beta_3 W_i + \beta^{IMF} D + \varepsilon$$

The dependent variable has been transformed into a difference form. The model includes the lag of target variables and policy variables. The regression results are obtained through simple ordinary least squares.

[i]The White standard error has been used by Conway (1994) and Dicks et al. (2000) as well.



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