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Policy

The IMF Choice

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Strangely "to go or not to go to the IMF" continues to dominate the economic debate in Pakistan. All manner of statements have come out of the economic leaders in the government and their advisers. "We don't need to go to the IMF if we ban importing luxury items." "We can borrow our way out of our problems for our problems are only current financing." "With borrowing, IMF will reduce any conditions." These statements merely show the lack of understanding of the role of the IMF.

As always, government has relied on hurriedly put together committees where people float in and out to consider this existential question. But the answer remains elusive.

So, let us clear the confusion.

Q1. Should We Dump the IMF?

The answer unequivocally is "NO" in the short run and "YES" in the long run if we work hard and make thoughtful well researched policy and have the ability to implement it.

The reason is simple and lies in an understanding of the global architecture. The IMF by global consensus is the last resort lender. Its blessings and certification are necessary for continuation of aid flows and retaining confidence of international markets. If the situation was normal in Pakistan, such a certification would not have been necessary. But with low and declining reserves, markets are jittery and hesitant to deal with Pakistan. Strong decisive action is necessary with or without the IMF. However, the reason for creating the lender of last resort was to calm jittery markets with an *IMF certification.*

Through our history, we have repeatedly gone to the IMF. No effort has been made to deal with our long-term policy and structural deficiencies. Instead, we thought all our problems lay in corruption. It is time, we re-evaluated our approach to policy. Thus far all governments failed to ward off the IMF only because policy has remained whimsical and lacked careful thought.

Q2. But Mahatir did not go to the IMF?

Indeed, he did not. Neither did he beg to put off reform. For anyone willing to examine the situation, he took the IMF medicine- exchange rate change, reducing deficits

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and undertaking reform—but refused to go to the IMF. He did all that was necessary to put Malaysia on track. Yes, his personal credibility and strong policy action kept the IMF away.

Q3. Friendly countries have come to help Pakistan and that will allow us to negotiate better with the IMF?

The cold hard truth is that no country helps another without a return. We need to be clear that loans need to be repaid. There is no such thing as a default.

The reason for going to the IMF is not borrowing money but to adopt a comprehensive set of policies to address the problem of declining reserves and widening deficits. Whoever designs a set of policies to deal with the ongoing haemorrhaging of the economy (the widening twin deficits and declining reserves) will have to target a return to normalcy (manageable deficits and a build-up of reserves) in a reasonable time frame of 3–5 years. Ultimately books have to balance. Haemorrhaging cannot be allowed to continue.

Markets watch problems that are arising and want to see a credible solution. Borrowing today to repay next year while problems remain unaddressed is no solution. When anyone (IMF) prepares an adjustment program they will have to plan policies that will include repayments on these borrowings. Much more may need to be done if the situation worsens.

Q4. The IMF has not been the solution in the past? Will their policies not hurt Pakistan?

Yes, Pakistan has been in an IMF program repeatedly. 22 programs in 70 years and yet achieved no lasting solution. Yes, IMF programs have been expedient and unwilling to touch deeper structural issues. That is the IMF fault. But all our governments have also not been ready to take any tough decision. They have always been eager for easy solutions.

To date we have clung feverishly to the Raj unwilling to tax agriculture, retaining colonial lifestyles including gifts from the exchequer without due process, maintain subsidies for the rich, stripping merit out of the system, and allowing social, judicial and governance capital to depreciate. For decades now, all commentators echo a sense of despondency with government and its inability to develop a state and its policy. All this has nothing to do with the IMF. These are secular trends. Unless we develop a modern functioning state, economic policy will never be properly made.

The IMF or any other donor or external friend can help us with putting our house in order. We must build a modern state and a modern society that is responsible and ready to participate in the global economy of the 21st century. Without that we will continue to bleed and require the IMF again and again.

Q5. So, what would you suggest for economic policy?

Sadly, our economic ministries lack the capacity to do this given that we have never prioritised thinking in our government and that the government hires no economists.

The recommended program would be:

- Develop a system where the exchange rate can never be overvalued by the whims of one man no matter who. A policy for exchange rate management should be put in place that focuses on the build-up of reserves and not on losing reserves as in the past decades.
- Over a year develop a serious tax policy reform for the following objectives:
    - Simplify taxes by removing withholding taxes and all presumptive taxes.
    - Remove all exemptions and get rid of the ability of the government to give exemptions.
    - There should four taxes only:
        - (i) Income tax with progressivity.
        - (ii) Corporate income tax in line with the rest of the world.
        - (iii) A GST with a lower rate than the current–say 8 percent but with careful implementation that widens its use and prevents avoidance.
        - (iv) A sensible tariff system devoid of regulatory duties and large exemptions and penalties.
- Eliminate subsidies except for those targeted toward the poor.
- Government to stop all commodity procurement that ties up bank credit to the tune of Rs. 400 billion and provides budgetary subsidies to rich farmers. No more procurement prices.Commit to an independent public sector expenditure review commission through a panel of local experts (no more than 5) to review public sector agencies and expenditure processes to curtail waste. Members of this commission will be paid and in office with staff and budget and with powers of inquiry and getting testimony.Government to develop a power market with decentralised discos and Gencos that are managed and operated on a profit-making basis. Defined subsidies will be given but the circular debt will be eliminated through governance and metering reform. In 3 years’ time most prices will be market determined in the power market.
- Gas Companies will be restructured to develop a gas market around the LNG system that has developed. They will be restructured into smaller companies but operating on a profit-making centre not on the current model of return on assets.
- Fresh gas pipelines will be curtailed.
- A plan will be developed to limit household gas supply and move gas to development of electricity.
- New gas companies will be empowered to explore and develop gas fields.
- The PSEs will be combined as intended by the government but with an independent holding company. But then key is to maximise autonomy. Professional management with complete autonomy to restructure, liquidate and manage investments for yield and growth will be critical.
- Revive regulation by professionalisation and autotomising regulatory agencies beyond politics and administration. Reform the public investment project for efficiency and yield. In the immediate 5 years, commit to no more public sector development projects. Meanwhile, develop plans to consolidate investment and

current budgets as in the rest of the world. In doing so move away from our current input-based budget framework to performance budgeting through the Medium-Term Budgetary framework (MTBF). Only mega projects that involve many sectors and agencies will remain with the Planning commission. The Planning commission will manage the MTBF and the performance-based management system.

Q6. Will this set of policies revive growth and employment and help the middle class?

These reforms are necessary if long term fiscal control is to be achieved. For decades, governments have taken the approach that fiscal control means only arbitrary tax increases. The corruption dialogue has increased the suspicions everywhere. The result is increased cost of businesses and investment. All this has done is create repeated crises and slow down growth.

Arbitrary and poorly thought out policies have slowed down growth and productivity as well as investment.

These measures will easily take about 3–4 years to implement even with a fully committed and strong government. But they alone will not accelerate growth.

To meet the employment needs of our youthful and growing population Pakistan must grow at over 8 percent per annum for the next 25 years. For this additional reform is a must. To do this, the government must undertake reform for:

- Developing serious policymaking and governance, by rolling back the colonial administration and legal system. In doing so, develop processes for serious analysis, research and policy development, and monitoring and evaluation. Without a concerted effort to reform our inherited colonial system, the economy will never work to capacity. We cannot run with a colonial legal and judicial system. The world has moved and so must we.
- The civil service must be reformed to do modern governance through rights, policy, monitoring and evaluation and not by direct controls and patronage. Such a system confuses control with policy and leads to waste.
- Currently one closed civil service system controls all government with junior grades and civil servants responsible for local government, mid-level responsible for provincial government and as they get senior, they control the federation. This is inefficient, wasteful, and destructive of local productivity and development.
- Even our democratic processes—election systems, power sharing, workings of parties parliamentary and government systems, term limits, constituency sizes—need review to ensure that effective legislation and parliamentary evaluation routinely happens.
- Develop capacity for market regulation that fosters competition, innovation and entrepreneurship as well as bankruptcy.
- Review markets to ensure competitive practices and markets with entry and exit.
- Phase out all protection and subsidies in a 5-year framework even if it means some industry must exit.
- Develop an approach to pricing water on actual use everywhere to begin rationalising its use and a as prelude to a sensible water policy as scarcity is beginning to take root.

- Local government is recognised by this government as important for service delivery and therefore for growth and broader development. Local government must empower city and metropolitan areas to grow into investment, entrepreneurship and innovation powerhouses that they are in rest of the world. Local government of the type required cannot happen with the colonial civil service with deputy commissioners and commissioners, positions that were meant for rural magistracy.
- The incumbent government picked the right slogan "5 million houses, 10 million jobs." It appropriately notes the role of the construction industry in a city as a leading industry. It also correctly pinpoints how building industry has a knock on effect on the economy. However, the government is being misled into thinking that government land and capital must go into this project of house building. If this project is to be done well, it must be seen as more than house building.
- Local governments must be prepared for the change in policy to provide a supporting role to denser development. Sprawling cities with housing colonies having single family homes, densified housing unit as a flat. It will raise tower cranes all over Pakistan by prioritising high rises and denser developments. · The current approach to city development has impeded development and hence stifled investment to the point that national investment and growth are being choked. Fragmented cities, poorly managed without imagination by an alien bureaucracy and no local representation. This needs to change.
- Government must stop hogging prime land for housing its officials and its offices for this is retarding investment and employment. If this land is released for investment in properly packaged city regeneration package for high-rise, mixed-use development, it will generate jobs and economic growth.

Q7. Are you saying there is a huge agenda even beyond the IMF?

We need the reform for ourselves not the IMF.

With years of research, this agenda seems clear and succinct. However, it is a huge agenda and will take years to implement even with capacity of high quality which we do not have. As it is this agenda is hard to comprehend in its fullness and we see commentators rush to the old, failed model of "government begging from foreigners and giving goodies to locals."

Society must begin to understand how we can grow the economy, and get out of this failed stabilisation approach which is seeking to preserve colonial models of the past for an apartheid society.

The decision is not whether to go to the IMF or not. It is whether to move from colonial Raj to the twenty first century. For that we need to undertake a lengthy and careful agenda of economic, administrative, legal and social reform. The IMF is only a stepping stone. The government must step over it fast and lead reform!