Beyond IMF: Redefining Economic Priorities for Sovereignty & Sustainable Growth

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Economics Department at the College of Economics and Social Development at the Institute of Business Management started a workshop series in Spring 2023. The workshops focused on studying the impact of IMF conditionalities on the specific goals and objectives that they were supposed to meet and overall economy. Sections 1 to 4 below are summaries of faculty studies on these conditionalities. Section 5 deals with Government of Pakistan's (GOP) plan to lease Karachi Port Terminal to Abu Dhabi Port Co. Section 6 discusses the performance of the State Bank of Pakistan in the post 'autonomous' 18 months. Section 7 deals with the GOP's Economic Revival Plan, while Section 8 concludes the seminar recommendations.

1. Inflation and Interest Rate.

Baig and Aboya estimated the long run (LR) and short run (SR) relationship between the interest rate, consumer price index (CPI) and the budget deficit in the presence of exchange rate, GDP using Johansen co-integration method. They found a long run association between interest rate and CPI. But the flow of relationship is from prices (CPI) to the rate of interest. **This indicates that inflation fluctuations have a positive significant impact on the interest rate, but there is no evidence of a reverse relationship from the interest rate to prices (CPI)**. **This may be attributed to the fact that using interest rate to control inflation has been ineffective in Pakistan. As interest rate as a policy tool manages demand pull factors of inflation, as inflation occurs mainly due to cost push factors in Pakistan.** This suggests that we need to pay attention to control cost push factors of inflation along with negative expectations about the future of the Pakistan economy. Budget deficit also has no statistically significant impact on the interest rate, vindicating the Ricardian hypothesis in the case of Pakistan. B**aig and Aboya state that their results do not support the conventional idea that high interest rates lead to lower inflation.**

2. Devaluation and Balance of Trade

The study by Rasheed, Zia and Lal empirically investigates the impact of currency devaluation on the trade balance of Pakistan using the ARDL approach. The findings clearly indicate a slightly-significant positive impact of currency devaluation on the trade balance only in the short run. However, in the long run the effect is negative and insignificant. **This shows that contrary to what the theory suggests, devaluation plays no role in determining the trade balance in the long run.** The comparison of two models suggest some non-alignment in the nominal exchange rate and the real effective exchange rate. Generally, theory suggests they move very closely, but the results suggest some ambiguity in determining the nominal exchange rate. Money supply shows a significant and negative effect on the trade balance. Monetary expansion leads to higher incomes in the short run and inflation in the long run. **Therefore, the government should use supply side policies instead of demand side policies to improve the trade surplus. Better supply side policies would also increase efficiency, productivity, lower inflation and increase export competitiveness.**

3. Interest Rate and the Exchange Rate.

Sheikh and Wizarat state that monetary authorities in Pakistan have been considering higher discount rate as a tool for strengthening the Pak Rupee, but the historical record after the early 1970s have shown that high interest rates did not stabilize the exchange rate. One of the reasons for the situation may be because high interest rate has always resulted in greater amount of public debt, thereby enhancing the amount going to debt servicing, which puts greater pressure on the Pak Rupee and results in weakening it. They recommend that monetary authorities lower the discount rate for the purpose of strengthening the Pak Rupee.

4. Privatization

Privatization in Pakistan seems to be politically conditioned and externally imposed, rather than fulfilling the needs of the domestic economic environment. Majority of the SOEs performed worse after privatization than before it. Most of the privatization programs completed in the 1990s and 2000s were characterized by corruption, nepotism and mismanagement mainly because privatization programs either served vested interest or poor implementation paved the way for the emergence of interest groups that were the real beneficiaries of privatization. The institutional mechanism that enables an effective regulatory environment to get relatively better outcomes and a well-functioning capital market that is a precondition for privatization are missing in Pakistan.

5. Awarding Karachi Port Terminal to Abu Dhabi Port Co.

Abu Dhabi Port Co. UAE has sought the control of Pakistan’s port terminals for 50 years without the transparent process of inviting bids. Pakistan which is in a difficult strategic and economic situation will face a serious security risk by allowing a country which is a strategic partner of India to run Pakistan's strategic port.

In 2006 the UAE had got a contract for running six US ports including New Orleans port, but due to extreme uneasiness in the US public, the US Congress cancelled the contract. On account of security concerns the US felt threatened to allow its port to be handled by tiny UAE.

The joint statement at the conclusion of Modi's visit to the US states and I quote from para 32: "President Biden and Prime Minister Modi reiterated the call for concerted action against all UN-listed terrorist groups including Al-Qa’ida, ISIS/Daesh, Lashkar e-Tayyiba (LeT), Jaish-e-Mohammad (JeM), and Hizb-ul-Mujhahideen. They strongly condemned cross-border terrorism, the use of terrorist proxies and called on Pakistan to take immediate action to ensure that no territory under its control is used for launching terrorist attacks. They called for the perpetrators of the 26/11 Mumbai and Pathankot attacks to be brought to justice."

This amounts to giving a green signal to India by the US to start a war with Pakistan. In such a situation Pakistan's strategic port will be operated by UAE, which has a strategic relationship with India and the US.

6. SBP Performance Evaluation.

Evaluating the performance of the SBP for the last 18 months Dr. Usman Chohan, at the Centre of Aerospace and Security Studies (CAA) evaluated performance on the basis of functional independence, statutory independence, inflation targeting and lending to the government. The author concludes that the State Bank of Pakistan Amendment Act (SBPAA) has failed on all four accounts.

First, the SBPAA aimed to make the SBP free of political interventions through greater statutory independence. He observes that the SBP has become *more subservient* to the government, "towing the same line even when it shouldn't, and leaving things to "Daronomics." Daronomics has not worked well, as the last economic survey shows, and the value of Rupee, inflation, government debt, credit ratings and money supply are all indicative of the failure."

Second, Chohan says the SBPAA allows the SBP to enjoy greater functional independence, allowing more freedom in choosing monetary tools to achieve the goals that *are deemed* most appropriate. He says the SBP has achieved only two things: raised interest rates and dabbled in letters of credit (LCs). This has resulted in raising rates to 21% which is the highest in the world and stifling economic activity, as the investor is better off with idle funds instead of investing them. The author says the LCs fiasco has turned the SBP into an "investment broker or export-merchant dealer, arbitrarily picking (or having picked for it) the winners and losers (and most are losers) in terms of who will be able to do business and who will not. This is a perverse role for a sober monetary authority to play, and it violates the spirit of any law written for a central bank anywhere, including the SBPAA. Therefore, the SBPAA has failed to get the functional independence for the SBP as well."

Third, the SBPAA has envisaged inflation-only mandate for the SBP. And this makes the inflation-obsession "a particularly horrifying stupidity of the foreign drafters of the SBPAA." And evaluating SBP on this account Chohan says SBP performance on this account is the worst in the history of Pakistan. He says " based on the miserable inflation that the public is facing, the SBP has failed beyond measure. Of course, a monetary authority can and should do much more than focus on inflation, and that too by using more than just interest rates when inflation is supply-side in any case."

Fourth, the SBPAA aims to bring some financial discipline through curtailing the SBP's monetary disbursement to a government that habitually lives beyond its means. Chohan says the SBP has achieved this through using banks to lend to the government: "government continues its borrowing binge, instead of shrinking its size and rationalizing its expenditures, while the SBP continues to bankroll this unsustainable trajectory. It is simply that the banking sector has become the vehicle for this practice instead, totally violating the spirit put into the SBPAA."

7. Economic Revival Plan

The $60bn economic revival plan to attract foreign investors in agriculture, industry, minerals, IT, etc. need to bear the following in mind: First, in the past Pakistan has not benefitted from foreign investment due to the ability on the part of the GOP to negotiate with foreign investors on account of rent seeking. It is, therefore, very important that the Government of Pakistan negotiating such agreements is honest and the agreements signed are transparent. Second, countries that have leased out their mines and exported minerals in raw form have suffered from the resource curse. It is, therefore, very important that we enter into agreements with friends who have the technology to cut and polish our stones, metals and minerals and convert them into manufactured goods. This way we can change our resource curse into a resource blessing.

8. Summary and Conclusion

Studies by all the learned authors have shown that orthodox economic policies advocated by the International Monetary Fund (IMF) have failed to achieve their objectives.

- Baig and Aboya find no evidence of a relationship from the interest rate to prices (CPI). As interest rate as a policy tool manages demand pull factors of inflation, but inflation is largely due to cost push factors in Pakistan.
- Their results do not support the conventional idea that high interest rates lead to lower inflation.
- Rasheed, Zia and Lal show that contrary to what the theory suggests, devaluation plays no role in determining trade balance in the long run.
- They suggest that the government should use supply side policies instead of demand side policies to improve trade surplus, increase efficiency, productivity, lower inflation and increase export competitiveness.
- Sheikh and Wizarat state that high interest rate have resulted in greater amount of public debt, thereby enhancing the amount going to debt servicing, which puts greater pressure on the Pak Rupee and is weakening it. He, therefore, recommends that monetary authorities lower the discount rate for the purpose of strengthening the Pak Rupee.
- Zubair and Wizarat state that privatization in Pakistan seems to be politically conditioned and externally imposed, rather than fulfilling the needs of the domestic economic environment. Majority of the SOEs performed worse after privatization than before it. Most of the privatization programs were characterized by corruption, nepotism and mismanagement mainly because privatization programs either served vested interests or poor implementations paved the way for the emergence of interest groups that were the real beneficiaries of privatization.
- Awarding Karachi Port Terminals to Abu Dhabi Port Co. which is trying to control Pakistan's port terminals for 50 years without the transparent process of inviting bids.
- Joint statement issued between the US and India amounts to giving a green signal to India by the US to start a war with Pakistan. In such a situation Pakistan's strategic port will be operated by UAE. We need to bear in mind the strategic relationship between India and UAE and the US and UAE.
- Evaluating the performance of the SBP for the last 18 months Dr. Usman Chohan, at the Centre of Aerospace and Security Studies (CAA) evaluated performance on the basis of functional

independence, statutory independence, inflation targeting and lending to the government. The author concludes that the State Bank of Pakistan Amendment Act (SBPAA) has failed on all four accounts.

- Economic Revival Plan should bear in mind that in the past Pakistan has not benefitted from foreign investment due to the inability on the part of the GOP to negotiate with foreign investors on account of rent seeking. It is, therefore, very important that the Government of Pakistan negotiating such agreements is honest and the agreements signed are transparent.
- Second, countries that have leased out their mines and exported minerals in raw form have suffered from the resource curse. It is therefore very important that we enter into agreements with friends who have the technology to cut and polish our stones, metals and minerals and convert them into manufactured goods.
- Instead of looking for countries and organizations from whom to borrow, we need to look within the country and work on an Alternative to the IMF spelt out by Wizarat.