SUMMARY of the Article "Negotiating effectively with IMF," by Saeed Ahmed, Dawn, May 31st, 2024

The article delves into the complexities of Pakistan's negotiations with the IMF for a new Extended Fund Facility (EFF) following the completion of the ninth-month Stand-By Arrangement (SBA). Given Pakistan's ongoing fiscal and external vulnerabilities, another EFF appears necessary amidst rising political instability. IMF programs, characterized by 'conditionality,' require borrowing governments to undertake economic reforms. Effective IMF programs hinge on negotiations and a medium-term economic agenda owned by the borrowing country's authorities, which should address root economic problems without alienating domestic interests. The professional and ideological alignments between IMF staff and borrowing government officials significantly impact negotiation outcomes, often resulting in larger programs with fewer conditions when ideological ties are strong. Pakistan's past experiences, particularly during the 2019-2023 EFF program, demonstrated that having a capable team with strong academic credentials and experience in multilateral institutions facilitated smoother negotiations and program implementations, even during challenges like the COVID-19 pandemic. However, the departure of such professionals led to delays in the ninth review and stringent IMF conditions. Currently, Pakistan faces capacity constraints, risking economic policy outsourcing to the IMF, thus necessitating a robust team for effective negotiations. Accurate projections of key economic variables like exchange rate, inflation, and GDP growth are crucial. The article highlights past instances where the State Bank of Pakistan (SBP) provided more accurate forecasts than the IMF, emphasizing the need for accountability within the IMF for erroneous projections. The government must exercise caution in agreeing to new IMF program terms, focusing on domestic resource mobilization, expenditure efficiency, structural reforms, non-debt-creating external inflows, and addressing energy sector issues. Tax reforms should target untaxed sectors to avoid social unrest and encourage investments. The new IMF program should have realistic policies to resolve issues like circular debt in the energy sector. The article concludes by stressing the importance of a capable negotiating team to avoid repeating past mistakes in IMF engagements.

Easy/Short SUMMARY:

The article discusses Pakistan's ongoing talks with the IMF for a new financial aid program due to the country's financial troubles and political instability. Effective IMF programs depend on good negotiations and strong local economic plans. In the past, Pakistan's skilled teams helped smooth negotiations, but the current team faces challenges. Accurate economic forecasts are crucial, and past disagreements on projections caused problems. For the new IMF deal, Pakistan needs to focus on raising domestic funds, efficient spending, business-friendly reforms, and solving energy issues. Tax reforms should target untaxed sectors to prevent unrest. The article stresses the need for a capable team to negotiate well with the IMF.

SOLUTIONS of The Problem:

Establishment of a Robust Negotiating Team

Assemble a team of skilled economists and professionals with strong academic and practical experience to negotiate effectively with the IMF, ensuring that Pakistan's interests are well-represented.

Accurate Economic Projections

Utilize advanced forecasting models to provide accurate economic projections for exchange rates, inflation, GDP growth, and the balance of payments, ensuring these forecasts are considered during negotiations.

Domestic Resource Mobilization

Implement policies to enhance domestic resource mobilization by broadening the tax base, improving tax collection efficiency, and targeting untaxed and under-taxed sectors to increase revenue without burdening existing taxpayers.

Expenditure Efficiency

Enhance expenditure efficiency by cutting down on non-essential spending, improving public sector management, and prioritizing investments that yield high economic returns.

Structural Reforms

Pursue structural reforms to improve the business climate, attract investment, and foster economic growth. This includes streamlining regulations, reducing bureaucratic hurdles, and ensuring a stable policy environment.

Non-Debt-Creating External Inflows

Focus on increasing non-debt-creating external inflows such as foreign direct investment (FDI), remittances, and export earnings to reduce reliance on borrowing and improve the external financial position.

Energy Sector Reforms

Address the root causes of issues in the energy sector, such as inefficiency, theft, and distribution losses, rather than relying solely on tariff increases and fuel taxes. Implement measures to reduce circular debt and improve the performance of power distribution companies.

Tax Reforms Focused on Equity

Design tax reforms that address equity issues by targeting untaxed and under-taxed sectors, providing tax credits to encourage business investments, and promoting private spending on education and health.

Accountability for IMF Projections

Advocate for accountability within the IMF for inaccurate economic projections, ensuring that future forecasts are reliable and based on sound methodology.

Commitment to Privatization

Commit to implementing a clear and transparent privatization agenda to divest loss-making state-owned enterprises (SOEs), reducing the fiscal burden and improving overall economic efficiency.

Continuous Professional Development

Invest in continuous professional development for government officials involved in economic policy and negotiations, ensuring they are equipped with the latest knowledge and skills to engage effectively with international financial institutions.

IMPORTANT Facts and Figures Given in the Article:

- Pakistan is negotiating a new IMF program following the completion of a nine-month Stand-By Arrangement (SBA).
- The country faces high fiscal and external vulnerabilities, necessitating another Extended Fund Facility (EFF).
- Effective IMF programs depend on strong negotiations and ownership of economic policies by the borrowing country.
- Professional and ideological alignments between IMF staff and borrowing government officials impact negotiation outcomes.
- Accurate economic projections are crucial for effective negotiations; past disagreements on projections led to issues.
- Key focus areas for the new IMF program include domestic resource mobilization, expenditure efficiency, structural reforms, non-debt-creating external inflows, and energy sector issues.
- Tax reforms should target untaxed sectors to prevent social unrest and encourage investments.
- The article emphasizes the importance of a capable negotiating team for successful IMF engagements.

MCQs from the Article:

1. What is the main focus of the new IMF program negotiations for Pakistan?

A. Increasing foreign loans
B. Implementing stricter tax policies
C. Addressing fiscal and external vulnerabilities
D. Reducing political instability

2. What significantly influences the outcome of IMF negotiations?

A. Professional networks and ideological orientation of IMF staff and borrowing government officials
B. The economic size of the borrowing country
C. The political stability of the borrowing country
D. The level of external debt

3. Which program requires high conditionality with specific targets and policy measures?

A. Stand-By Arrangement (SBA)
B. Extended Fund Facility (EFF)
C. Poverty Reduction and Growth Trust (PRGT)
D. Rapid Credit Facility (RCF)

4. What is a critical aspect of negotiations with the IMF according to the article?

A. Reducing government expenditure
B. Increasing foreign debt
C. Agreement on key economic assumptions
D. Enhancing political stability

5. What led to delays in the ninth review of Pakistan’s previous IMF program?

A. Lack of funding from the IMF
B. Political instability in Pakistan
C. Departure of key professionals from the negotiating team
D. Increased borrowing from other countries

6. What does the article suggest is necessary for successful tax reforms?

A. Increasing taxes on existing taxpayers
B. Targeting untaxed and under-taxed sectors
C. Reducing tax rates across the board
D. Eliminating tax credits for investments

7. Which sector does the article emphasize needs realistic policies and targets in the new IMF program?

A. Agriculture
B. Energy
C. Technology
D. Healthcare

8. What historical issue with IMF projections does the article highlight?

A. Inaccurate projections leading to policy disagreements
B. Excessively optimistic economic forecasts
C. Overestimation of political stability
D. Underestimation of fiscal deficits

9. What should be a key component of Pakistan’s economic strategy according to the article?

A. Increasing borrowing from international markets
B. Reducing exports to stabilize the economy

C. Enhancing non-debt-creating external inflows
D. Increasing reliance on traditional energy sources

10. What does the article identify as a major cause of circular debt in Pakistan’s energy sector?

A. Low energy production
B. High energy tariffs
C. Inefficiency, theft, and distribution losses
D. Excessive foreign investment

VOCABULARY:

1. **Vulnerabilities** (noun) (□□□□□□□□): Susceptibilities to harm or attack.
2. **Instability** (noun) (□□□□□□□ □□□): Lack of stability; tendency to change unpredictably.
3. **Conditionality** (noun) (□□□□□□□): The quality of being subject to conditions or requirements.
4. **Outsourcing** (verb) (□□□□□ □□□□□□): Obtain goods or services from an outside supplier.
5. **Memorandum** (noun) (□□□□□□□): A written message in business or diplomacy.
6. **Projections** (noun) (□□□□□□): Estimates or forecasts of future situations based on current trends.
7. **Stringency** (noun) (□□□□): Strictness or severity.
8. **Contingency** (noun) (□□□□ □□□□□): A future event or circumstance which is possible but cannot be predicted with certainty.
9. **Vindicated** (verb) (□□□□ □□□): Cleared of blame or suspicion.
10. **Unaccountability** (noun) (□□□□□□□ □□□ □□ □□□ □□□□): Lack of accountability.
11. **Mobilization** (noun) (□□□□): The action of making something movable or capable of movement.
12. **Inefficiency** (noun) (□□□□□□): Lack

of efficiency or effectiveness.
13. **Burgeoning** (adjective) (□□□ □□□□□□): Growing or expanding rapidly.
14. **Realistic** (adjective) (□□□□□□□ □□□□□): Having or showing a sensible and practical idea of what can be achieved or expected.

15. **Alienated** (verb) (□□□□ □□□): Made to feel isolated or estranged.
16. **Recalcitrance** (noun) (□□□□□): The quality of being uncooperative or resistant.
17. **Assumptions** (noun) (□□□□□□□): Things that are accepted as true or as certain to happen, without proof.
18. **Agenda** (noun) (□□□□□□): A list of items to be discussed or acted upon.
19. **Consensus** (noun) (□□□□ □□□□□): General agreement.
20. **Privatization** (noun) (□□□□□□): The transfer of ownership of property or businesses from a government to a privately-owned entity.

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Negotiating effectively with IMF

Saeed Ahmed

FOLLOWING the completion of the ninth-month Stand-By Arrangement (SBA), discussions are ongoing between Pakistan and the IMF for a successor programme. Given that Pakistan's fiscal and external vulnerabilities remain high, another Extended Fund Facility (EFF) arrangement seems inevitable. The country also faces heightened risks of political instability.

IMF programmes result from a negotiation process between governments and IMF staff, producing an 'adjustment programme' of economic reforms or 'conditionality' that the borrowing government must undertake. Typically, the EFF is a 'high conditionality' programme with specific targets and policy measures. For any IMF programme to be effective, it must include policies and programmes that are genuinely owned by the borrowing country's authorities. The success of such programmes depends on the quality of negotiations and a well-defined medium-term economic agenda that addresses the root causes of persistent economic problems, without alienating domestic interest groups.

The professional networks and ideological orientation of the IMF staff and borrowing governments, can significantly influence negotiation outcomes. The Fund staff wield significant authority during negotiations. Professional networks, often based on similar academic and professional backgrounds, increase staff trust and form the political basis for power and influence. Cross-country research on IMF programmes shows that as ideological ties and similarity between the Fund and borrower country officials increase, IMF programmes become larger, with fewer binding conditions. This indicates that borrowing governments can influence negotiations through narrative strategies based on shared ideology.

Our experience with the IMF during the last EFF programme supports this notion. When Pakistan's team at the finance ministry, the central bank, and IMF Executive Board included professionals with strong academic credentials and experience in multilateral institutions, the design and implementation of an extended arrangement and approval of eight reviews under the 2019-2023 EFF programme proceeded smoothly despite challenges. The country also received emergency financing support of $1.386 billion during the Covid-19 pandemic. However, after the departure of this team of professionals, the ninth review faced delays, and the programme remained incomplete for various reasons, including the stringency shown by the IMF staff and management.

The government must exercise caution while agreeing on the contours of the next IMF programme.

Given the capacity constraints currently faced by Pakistan's team, it is likely that economic policymaking will be outsourced to the IMF. Pakistani authorities may then end up merely signing off on a 'Letter of Intent' and 'Memorandum of Economic and Financial Policies', crafted by Fund staff. Notwithstanding his vision and commitment, Finance Minister Muhammed Aurangzeb needs a robust team of economists and professionals to negotiate effectively with the IMF.

Another critical aspect of negotiations involves agreement on key assumptions related to the forecasts of the exchange rate, inflation, GDP growth, and balance-of-payments as fiscal planning and monetary policy decisions depend on these variables.

Previously, projections by State Bank economists, based on advanced forecasting models, have proven more accurate than projections used by IMF teams. For instance, during the EFF programme negotiations in April-May 2019, the SBP accurately projected the dollar to rupee average exchange rate for FY20, following the transition to a market-determined exchange rate regime, to be around Rs162, whereas IMF projected it to be between Rs177 and Rs182 with a view to exerting harsh conditions on Pakistan. The actual exchange rate (Rs161.91) aligned with the SBP's forecast. This difference between the SBP and IMF on such projections led to the departure of SBP governor Tariq Bajwa and finance secretary Younus Dagha from their offices, as they resisted the IMF-projected exchange rate and inflation numbers and associated policy prescriptions. History has proven that their stance was correct. Sadly, there is no accountability within the IMF for producing erroneous projections.

Another example is the FY24 current account deficit, which the IMF projected at $5.649bn at the start of the SBA programme, but revised to $3bn. Based on these inflated current account deficit estimates, the IMF had untenably asked Pakistani authorities to arrange for financing assurances to meet the full external financing needs for completing the ninth review. The off-the-mark current account deficit projections have vindicated the stance taken by then finance minister Ishaq Dar who had protested against IMF's exaggerated projections to put undue pressure on Pakistan. Also, the SBP has consistently produced more robust and accurate inflation forecasts than the IMF.

That said, it is critical for the government to exercise caution while agreeing on the contours of the next IMF programme. These must include domestic resource mobilisation and expenditure efficiency, structural reforms to improve the business climate, solid measures to increase non-debt-creating external inflows, and solutions to address the root causes of long-standing energy problems. There must also be a commitment to implementing the agreed privatisation agenda to get rid of loss-making SOEs.

Further, tax reforms must focus on equity issues within the tax policy. To prevent social unrest, tax reforms should target raising revenues from untaxed and under-taxed sectors rather than squeezing existing taxpayers further. Tax credits should encourage business investments and private expenditure on education and health by individual taxpayers. Similarly, within the energy sector, previous IMF programmes failed to resolve the burgeoning circular debt through tariff increases and unjust fuel taxes alone. The circular debt swells due to inefficiency, theft and losses faced by power distribution firms. The new IMF programme must have realistic policies and targets, instead of relying on outdated structural conditionality, which has not yielded fruitful results, has alienated citizens, and stifled economic growth.

Pakistan's initial experience under the 2019-2023 EFF programme underscores the importance of having a capable team that can negotiate effectively. Without such a team to formulate home-grown economic policies and get the IMF to agree to these, the country risks embarking on yet another programme like the previous 23.

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