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Avoiding the lender of last resort

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Pakistan faces a severe crisis because of economic and political instability that persisted over the last one year. Due to the unprecedented trade and current account deficits, the country's foreign exchange reserves have depleted to a little over $10 billion.

While the State Bank of Pakistan (SBP) borrowed foreign currency in the forward market from commercial banks, the country's net foreign exchange reserves stand around only $4 billion.

In its annual plan, the last government underestimated the current account deficit at $15bn for 2018-19.

Given the fact that the current account deficit remained $18bn in 2017-18, the gap for 2018-19 is going to be around $21bn in case the government does not take any policy measure to reduce it.

Accounting for the current account deficit of $21bn with external debt servicing of around $10bn, the country's financing needs are going to be $31bn for 2018-19.

On the other hand, available financing based on projections by the Ministry of Finance for foreign direct investment, net expected loans from multilateral and bilateral sources, anticipated issue of sovereign bonds and commercial borrowings is $12bn. Therefore, the financing gap is around $19bn as the country desperately looks for financial support from bilateral and international creditors.

An IMF programme focuses on curbing demand through austerity measures while ignoring the supply side of the economy. This results in recession, poverty and unemployment

Many options, including that of the International Monetary Fund), are available. If the country goes to the IMF, it will have to accept its conditions that have heavy costs such as further devaluation of the rupee against the dollar along with a two percentage point downward adjustment in the estimated fiscal deficit from 6.8 per cent to 4.8pc of gross domestic product (GDP) in 2018-19.

This will not only fuel inflation, but also reduce GDP growth by two percentage points from 5.7pc in 2017-18 to 3.7pc in 2018-19, leading to a higher unemployment rate and increased poverty level.

It is noteworthy that the major limitation of the IMF programme is its focus on curbing the demand side in an economy through austerity measures whereas ignoring the supply side of the economy. This results in recession, poverty and unemployment.

While any adjustment to bring the country's expenses within limits is a fact of life, the experience of several developing countries in Africa tells another tale. It shows that the countries that adjusted themselves by following their own policies were better off than those that undertook adjustment programmes as per the IMF's policy prescriptions. Evidence shows that IMF programmes failed in many developing countries and contributed to debt, recession and poverty.

It is, thus, important to find an alternative approach to adjustment. The financing gap of $19bn can be filled by doing a downward adjustment in the trade deficit by reducing imports of non-essential goods by $7bn through regulatory and administrative measures and increasing exports by $3bn through reforms and an incentive package.

The remaining $9bn gap can be filled by seeking loans from China and Saudi Arabia and/or rolling-over existing foreign debt, which will give a breathing space to implement structural reforms to correct fiscal and current account imbalances.

This scenario augurs well for the economy since the cost of adjustment is low. It allows some fiscal space to pursue growth-oriented policies along with structural reforms to achieve a respectable GDP growth rate of around 5pc in 2018-19.

In addition, we need to strengthen our poorly regulated financial system to reduce speculative capital flight, which will stop a drain on foreign exchange reserves.

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