

Pakistan's Debt of Gratitude

The International Monetary Fund's (imf's) generous loan to Pakistan last December has revived criticisms that the fund is first and foremost a tool of U.S. foreign policy. True, as a Cold War American ally, Pakistan was the world's third largest recipient of foreign aid over the last four decades. But even after those Cold War ties were broken, Pakistan continued to participate in imf programs throughout the 1990s, suggesting that the real problem is not geopolitical nepotism but the inability of the imf and the developing world to learn from past mistakes—most notably, redistributing income toward elites while failing to promote economic growth. | **By James Raymond Vreeland**

IMF "arrangements" are spelled out in a "Letter of Intent"—written by IMF staff and government officials—formally sent from the country's finance minister to the IMF managing director, who subsequently brings it before the IMF Executive Board for approval. This arrangement was approved on December 6, 2001.

**Pakistan—Letter of Intent,
Memorandum of Economic and Financial Policies,
Technical Memorandum of Understanding
November 22, 2001**

The government of Pakistan has adopted an economic reform program for 2001–2004, which aims to increase sustainable growth and strengthen basic social services as the central pillars of its poverty reduction strategy... In support of this program, we request a three-year arrangement under the Poverty Reduction and Growth Facility (prgf) in an amount equivalent to sdr ["Special Drawing Rights" (1 sdr ≈\$1.25)] 1,033.7 million (100 percent of quota)....

U.S. concerns over the stability of the Pakistani regime might explain why this IMF arrangement is more than double the one that expired in September 2001 and is offered at a reduced interest rate.

Having finished with the ritual opening, the letter proceeds to describe Pakistan's implementation of IMF policy conditions to improve economic growth and reduce poverty. Most statistical studies of IMF programs report, however, that the IMF is unsuccessful in these areas—a failure that was highlighted in the East Asian financial crisis and subsequently in Russia, Brazil, and now Argentina. This critique also holds for less extreme cases, even accounting for the fact that countries seeking IMF assistance are usually already struggling with bad economic conditions.

Pakistan has participated in consecutive IMF arrangements since 1993 and before that in 1958–9, 1965–6, 1968–9, 1972–5, 1977–8, 1980–3, and 1988–91. If IMF programs were more successful, governments would not need to ask for more aid.

To consolidate the progress achieved and to firmly set Pakistan's economy on a path towards high growth and poverty-reduction, we have launched an ambitious and far-reaching medium-term economic reform program ... for which we request Fund support under a three-year Poverty Reduction Growth Facility (prgf) arrangement. In view of the consequences of the September 11 events, the outlook for Pakistan's economy is subject to higher-than-usual uncertainty, but this has only reinforced our determination to persist on the path of reform and macroeconomic stabilization....

The events since September 11 have scared away investors, business people, and tourists and may cost the economy \$5 billion. Also, soaring insurance rates have made exports less competitive.

The letter then goes on to outline Pakistan's poverty reduction strategy. In the past, explicit conditions concerning poverty were not typically included in IMF agreements. It used to be assumed that if countries followed the fund's goals and pursued sound fiscal management, poverty would decline automatically. The problems may have been due to program implementation. Governments have been known to comply with some conditions and ignore others, using the leverage of the IMF to push through only policies that benefit elites and please creditors.

The government is strongly committed to undertaking specific actions to reduce the burden of poverty affecting the people of Pakistan. We believe that growth and the related income-generating opportunities are essential in reducing poverty over time, but we also know that in a context where about one-third of the population is poor, it is not possible to wait for the benefit of growth to trickle down and address the poverty issue....

To implement a full poverty reduction strategy, the World Bank estimates that Pakistan will have to aim for an economic growth rate of 7 to 8 percent for at least 10 years.

Next, Pakistan describes its plans for getting its fiscal house in order. The IMF has continued to enter into arrangements with Pakistan, even though the annual budget deficit has averaged over 6 percent of the gross domestic product (GDP). When Pakistan entered into a three-year arrangement in 1997, the government committed to reducing the fiscal deficit from 6.1 percent of GDP to 4–4.5 percent by 2000. Although this target was not achieved, the recent government has been more successful, reducing the deficit to about 5.6 percent of GDP.

Over the medium term, we plan to allocate a rapidly growing share of budgetary expenditure to growth-enhancing and poverty-reducing outlays. Specifically, we aim to increase the development budget by 1.2 percentage points of gdp over the three-year period, and broadly defined social and poverty-related expenditure by 0.6 percentage points. A start has been made with the 2001/02 budget, while further plans will be formulated once various major initiatives (such as the education reform strategy ...) are costed and appropriate monitoring mechanisms are in place. At the same time, we will reduce the share of other categories of spending, including the defense related expenditure....

Officially, the IMF frowns on large defense expenditures, which it labels “unproductive spending.” But Pakistan does not commit to how much it will cut from its defense budget, which is twice as large as the budget for health, education, and business development programs.

Shortly after this IMF arrangement was approved, Pakistan achieved an unprecedented restructuring of its entire stock of \$12.5 billion sovereign debt from the Paris Club, an informal group of creditor governments.

Pakistan will need to mobilize large financial support from the international community to cover the external financing gap of the next three years.... [W]e will seek additional multilateral financing, further rescheduling from Paris Club and other bilateral creditors on concessional terms, and grants from bilateral donors, including the extension of the Saudi oil grant beyond September 2002....

The letter then discusses program monitoring. If the IMF deems that a government is not making sufficient progress complying with conditions, loan disbursements can be suspended or arrangements can be cancelled. Under Pakistan’s previous Stand-by Arrangement, the government passed all three IMF reviews, obtaining each of the promised disbursements of credit on time. Two of the three reviews were before September 11, 2001, suggesting that Pakistan would have secured a new agreement even if its aid were not required for the U.S. effort in Afghanistan.

The new prgf arrangement will involve quarterly reviews and disbursements. The period for the first year of the program is October 2001–September 2002. The first review will be completed by end-March 2002 and will focus on the implementation of macroeconomic policies, progress in tax administration reforms, and progress in monitoring fiscal expenditure, especially for social expenditures and outcomes. The second review will be completed by end-June 2002.

In 2000, the Pakistani government admitted that the previous administration fudged tax data it gave to the IMF, thereby encouraging the fund to provide money that might otherwise have been withheld.

James Raymond Vreeland, assistant professor of political science at Yale University, is author of The IMF and Economic Development, forthcoming from Cambridge University Press.

FP welcomes submissions to *Between the Lines*. Contributors should consult the writers’ guidelines at www.foreignpolicy.com.