IMF policies: A step forward

By

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The unexpected reduction of discount rate of 150 basis points by the State Bank of Pakistan (SBP) has surprised many. Some view this reduction as inflationary and argue that the current rate of inflation prevailing within the country did not justify this reduction as within the local banking sector, government borrowing has touched almost 240 billion rupees in the first quarter of this fiscal year.

All of this borrowing has been from the commercial banks that deprived the private sector to utilise this size of credit. It seems interesting that the private sector was not willing to come forward and utilise this size of credit from banks due to the discount rate being very high for viable business opportunities.

Obtaining this credit from private banking system itself reflects huge interest payments by the government that is likely to widen the fiscal gap that is already expected to reach at alarming level.

Running a high fiscal deficit encourages risks of higher inflation especially in the absence of any serious effort to increase tax collection, reduction in subsidies and with almost bankrupt bleeding public sector enterprises.

Some of the inflationary pressure is also attributable to rupee losing its value against other currencies, high interest rates and higher energy prices.

This has made the manufacturing sector uncompetitive. The local currency remained volatile especially against US Dollar and rupee has depreciated by 0.8 per cent since the start of this fiscal year.

In the absence of foreign funding for the fiscal deficit due to US Pak relations worsening, the necessity of filling the deficit gap falls mainly on local tax collection, which is not available due to severe recessionary trend where productivity has been severely affected due to irregular supply of electricity and gas and that too at substantially higher prices.

This indicates that the fiscal deficit is not likely to come down anytime soon. They are of the view that on these grounds the SBP should have put hold the discount rate on hold at previous level.

Others argue in favour of this reduction. They feel that the SBP's has taken a very bold step by reducing discount rate. The discount rate has been slashed by 200 basis points during the last two months.

The business community welcomed the reduction and has termed it a first bold step toward that should ensure a sustained economic growth but insists that it is not enough to ensure additional investment that should lay the foundation for sustained economic growth.

The chairman All Pakistan Textile Mills Association (APTMA) welcomed the new measures but warned that anything less than a single digit discount rate would not help revive the economy.

He pointed out that without a single digit discount rate additional investment would remain shy and economic growth would remain slow as too high a discount rate does not justify a viable business investment.

The unexpected and sudden slash of discount rate by 150 basis points in one go was unexpected and is viewed by many as a start of liberal economic and monetary policy of the present government that would be helpful for an investment oriented economy.

It also indicates that during the coming months of this fiscal year, the discount rates should touch around single digit that should ensure new investment for our stagnant and depressed economy.

By slashing rates of return on government saving schemes, a clear message has been sent given that more funds are needed in productive sectors.

Capital markets should get larger portion of private savings as businesses should benefit from lower interest rates resulting in viable business propositions that should generate healthy profits.

This should also be means to enlarge tax payer's base and would help collect sizeable amount of direct and indirect taxes. It is predicted that productivity would improve through additional investment and lower costs.

Lower interest rates should help banks to reduce their Non-Performing Loans (NPLs) as it would be easier for the businesses to pay back their loans. This should make banking sector healthy to provide funding to private sector resulting in economic revival, growth and enhanced competitiveness globally.

In return it should provide additional jobs to young generation thereby reducing the unemployment figures and indirectly improving law and order situation within the country.

Once the growth engine starts moving, it should reduce the gap between supply and demand. This should slow down inflationary trend. The improvement in supply line should contribute an additional revenue for the government exchequer. Additional tax collection is badly needed to improve budgetary deficit to fill the gap of declining availability of foreign funding.

The efforts by the Federal Board of Revenue (FBR) to collect additional revenue in the absence of any real growth in our economy had been grossly unsuccessful.

It was generally felt that FBR's efforts to squeeze the existing tax payers through sending vague notices without any real evidence of misstatement of income were not only harsh but also illegal that frightened the existing taxpayers who were struggling to survive in a stagnated economic situation.

The economic slowdown and inflationary trends also resulted due to hard conditionality that was imposed by International Monetary Fund (IMF) as part of its funding program.

As the government has recently announced its intention to say goodbye to IMF funding, now it seems justifiable for the government to form its own growth oriented monetary policies that suits our economic needs and meets our temperament rather than rely upon imported solutions to our economic problems.

This change of strategy should take out the economy from its depression to a more growth oriented economy. The cut in interest rate has been always justified if the economic growth is threatened. There are several world class examples that should guide us on this issue rather than adopting the customary view that inflation can only be controlled through rising interest rates and curtailing demand without identifying the causes of inflation.

There are other economic tools that are more effective than the customary solutions. Recently, Indonesia's central bank decided to cut rates that surprised many analysts. The Bank slashed 25 basis points to 6.5 per cent.

This rate cut has resulted in Indonesia joining Brazil and Turkey in cutting interest rates amid fears of slowing global growth. It is expected that other countries of the region may follow suit.

Indonesia's rate cut was taken "to anticipate and mitigate the impact of global economic and financial slow down to Indonesia's economy and to shield the currency from the impact of global financial turmoil." It is predicted that if growth slows down in the region; other economies may well choose the Indonesian path of cutting down the interest rates to encourage growth through more investments resulting in comparative competitive costs.

If we analyse western developed economies that are facing economic slowdowns, stagnant growth, high inflation and sluggish demand, we see that the governments have in fact acted differently by reducing bank rates to curtail inflation through accelerating growth to take the economies out of recession.

For example, in Britain the inflation of around 5.0to 5.5 % is expected annually by the government, but the economic managers are keeping the interest rates down between 0-1percent per annum so far, to ensure economic growth through additional investment and liberal bank credits.

The policy of minimum or negligible interest rates amounts to negative interest rate as inflation is higher than the bank rates.

Similarly, more and more nations are opting for lower interest rates to stimulate economic growth and ensure more investments to make it possible for the economies to come out of recession and adopt a growth-oriented posture to ensure increase supply of goods and services.

We should learn lessons from the case studies of other economies, their problems and the solutions that were adopted to resolve their economic challenges and we should formulate our own policies carefully that meets our peculiar case and put our economy to grow at a faster rate.

Disassociating from IMF conditionality should provide us an opportunity to solve our economic issues through our own tailored solutions that suit us. At the same time, the government should be less dependent on bank borrowings by curtailing non development expenditure.

More tax collection is required through long term fiscal policies by removing various anomalies and encouraging oversees Pakistanis to remit more funds to Pakistan through long term measures that should provide incentives for keeping money with Pakistani commercial banks.

The government should borrow money from oversees Pakistanis instead of IMF or other lending institutions by ensuring a fixed exchange rate so that Pakistani's do not lose on exchange rates.

All these measures should accelerate growth without any conditionality that has harmed our economic independence.

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