The Last IMF Program?

Mushtaq Khan, October 18, 2018

As high-level negotiations for the next IMF program are scheduled to start on 7 November, we look at what this means for the country in the months ahead. Many will dismiss the need for such an exercise, as this is a familiar path – many would argue that it's same ol', same ol': the Rupee will lose value; fuel prices and power tariffs will increase; and inflation will squeeze household budgets.

Even posing the question whether the next program could be Pakistan's last, is likely to be ridiculed. However, the confluence of factors – key among them the PTI political mandate – suggests that if this government is willing to use its political capital; reach out to generate public support for economic reforms; and use its special relationship with China, it is well placed to make politically difficult choices that have intimidated governments in the past three decades.

Hesitant start with missteps

Many people now claim that PTI's leadership knew it would win, so why was the economic team so hesitant about revealing its economic solution? After all, Pakistan's economy was grappling with an acute external sector problem, which has been brewing for well over a year before they came into power.

Something needed to be done, but little was forthcoming.

Instead, what captured the media's attention were missteps: an interview to the FT by a government advisor who expressed some skepticism about CPEC; and more damaging, the removal of Atif Mian from the Economic Advisory Council (EAC), on account of his religious beliefs. The latter disappointed many PTI supporters, who expressed their anger via social media. Losing traction with your political base so soon after coming into power is a bad start.

For a country that is prone to cynicism, it was back to normal.

Some positive steps

On two consecutive days (17 and 18 September), the PTI government stepped up. On the 17th, the government decided to increase gas tariffs, with the higher slab users facing a 143% increase in price. In our view, this pricing change was long overdue, but is still insufficient. Natural gas is criminally underpriced, which has resulted in over-usage and wastage. The concession of lower hikes on the poor and middle class to ease their financial burden is pure politics[1] – their monthly gas bills are trivial compared to the cost of cell phones and mobile services, which are eagerly consumed. Having said this, the government did not increase gas tariffs on exporters and some registered manufacturers.

On the 18th, Asad Umar announced a mini-budget for FY19. In a congenial, bipartisan atmosphere, the Finance Minister reversed the tax cuts that the previous government had announced just before the end of its term. This reversal was largely anticipated, as Pakistan could hardly afford to reduce captive tax revenues when facing a growing fiscal deficit. The mini-budget revealed a progressive agenda as it eased the tax burden on the less affluent, and introduced subsidies for low cost housing and healthcare. The

[1] This was done to stave-off criticism from opposition political parties, which have used new gas connections and cheap gas as rewards for political support during their terms in power.

most significant move was the sharp reduction in the Public Sector Development Programme (PSDP), which is impressive so soon after being elected to power.[2]

Then came the bad news. The FM rolled-back the restriction that tax non-filers could not purchase automobiles and properties. The disingenuous justification of this walk-back, suggesting that expat Pakistanis were also non-filers was sharply criticized by just about everyone. In effect, the mini-budget was overshadowed by the assessment that the PTI government had conceded to powerful interests, and had gone back on campaign promises to prosecute the rich and influential.

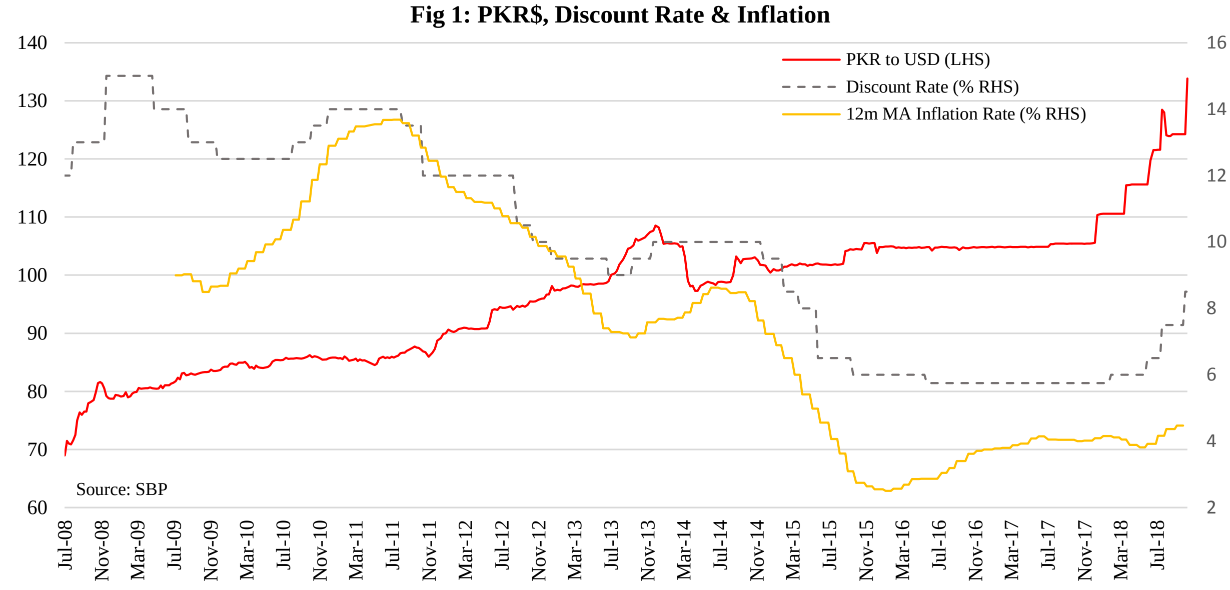
From our perspective, the mini-budget was necessary but inadequate. Other than the orthodoxy that the fiscal deficit is the mother of all economic ills (i.e. fix the fiscal side and the external sector will be brought back to balance), there was nothing in it about how to narrow the current account deficit. As we have said repeatedly, Pakistan's external sector needs immediate attention, and cannot rely on fiscal consolidation to do the job.[3]

The only silver-lining to this mini-budget is that the concession to non-filers was subsequently reversed.

Talking more constructively about the IMF

In the past week, the FM acknowledged that Pakistan has no choice but to return to the IMF. We had a sense about this, as the GoP has yet to release its BoP projections for FY19, even though we are in the fourth month of the year. In our view, these projections (more than anything else the government could put forward) will determine the country's path ahead. We believe this has been delayed intentionally, and will only be announced after negotiations are complete and the timeline for the next program is finalized.

Fig 1: PKR$, Discount Rate & Inflation



Media coverage which said that the IMF and GoP disagree about the PKR/$ parity and interest rates that should be in place by mid-2019, has created some confusion in the market. On 4 October, the *Express*

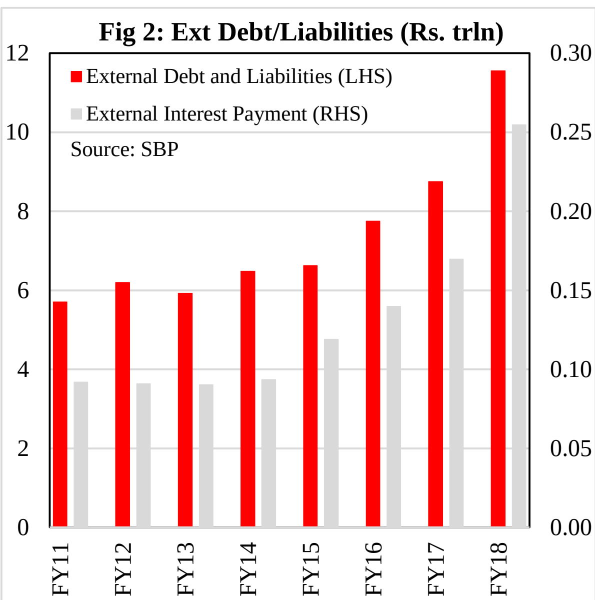
[2] We would argue that this cut should not necessarily reduce social development in the country, as the PSDP is regularly curtailed at the end of the fiscal year – also, development projects are often over-inflated as an avenue to siphon off money. In our view, the PTI government may have cut PSDP projects that are primarily used by provincial governments to siphon off money.
[3] In a press conference after the budget speech, the FM casually mentioned that the current account deficit in FY19 could be in the range of $ 18 to $ 21 billion. This stunning revelation was not picked up by the local media, but from our perspective, if the GoP intends to maintain status quo on the external sector, the country is heading for trouble.

Tribune's Shahbaz Rana stated that the IMF would like to see the currency at 145/$, while SBP thinks a rate of 137/$ is more suitable. This has strongly influenced market expectations, which would explain the sharp weakening on 9 October, when SBP allegedly withdrew its support level of 124/$. In a matter of just hours that morning, the PKR/$ parity traded at levels of 137-138/$, before SBP stepped in to stabilize the currency at 133-134/$.

Clearly the market has accepted these changes as a prelude to the next IMF program. What it may not be aware of, is the magnitude of these changes in the context of what has happened in the past decade (see **Figure 1**). As shown, the moves witnessed since December 2017 are quite significant, and the repercussions will play out in FY19.

Orthodoxy vs. Reality

In two recent papers (*The vicious twin deficits*, Part 1 & Part 2, April and May 2018) we argued that Pakistan is already trapped in a reinforcing twin deficit. More simply, if only orthodox demand management (i.e. the PKR and interest rates) is used to narrow the external deficit, this would put additional fiscal pressure on the country.[4] As shown in **Figure 2** and **3**, the Rupee value of Pakistan's domestic and external debts has trended up in the past several years. To gauge what is likely to happen in FY19, **Figure 1** will help.



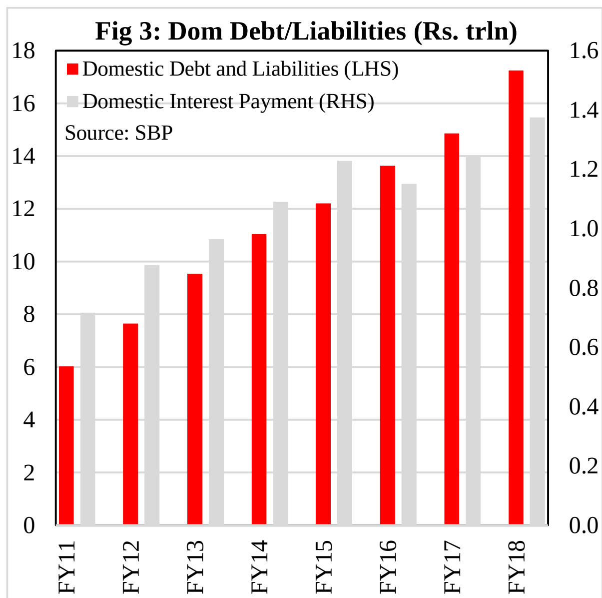


Figure 2 shows that the stock of Pakistan's external debt/liability increased by 32% in FY18, but servicing this debt posted a 50% increase. This is because of the quantum of borrowing and the pricing of this marginal debt – this does not *fully* reflect the PKR depreciation since December 2017, which will be reflected in FY19 (see **Figure 1**). Looking ahead, we do not expect the quantum of fresh borrowing to increase as much as it did in FY18, but rolling over short-term dollar loans (read PKR depreciation), with an increase in Pakistan risk and rising US interest rates, will be painful in terms of the debt servicing burden this year.

Unfortunately, the story with Pakistan's domestic debt is no better. As shown in **Figure 3**, the stock of domestic debt has increased in almost a linear fashion, which is likely to continue during this fiscal year.

[4] Pakistan's domestic debt increased quite sharply last year, and is very short-term. This means that an increase in interest rates in 1H-FY19 will have an immediate impact on debt servicing this fiscal year.

Box 1: Orthodoxy vs. Reality

Orthodox economic theory is water-tight. It dominates the training of all economists, and strongly influences the thinking of most non-economists. As John Maynard Keynes once said:

Practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.

While we cannot argue against the internal logic of economic orthodoxy, we disagree with the IMF's neoclassical mindset when it comes to stabilization policies in developing countries like Pakistan.

From the IMF's perspective, prices are primarily driven by demand pressures. To contain inflation therefore, interest rates must be increased to reduce aggregate demand – increasing interest rates will also reduce import demand and narrow the external deficit. Furthermore, a weaker PKR will reduce import demand and increase exports, which will narrow the trade deficit.

In our view, an increase in interest rates will do more to pump up the fiscal deficit than reduce inflation – in all likelihood, this increase in the fiscal deficit could itself stoke inflation. Furthermore, a weaker PKR will immediately be reflected in higher inflation, which will force the central bank to increase interest rates – again, this will come back to put further fiscal pressure in the short-term. From our perspective, since aggregate demand (consumption and investment) is not as sensitive to interest rates as it is in more developed countries, an increase in interest rates may not have much impact on demand pressures (or import demand) but could increase default rates in commercial banks. These banks will happily shift their lending to the government and crowd out the private sector.

Our views diverge from those of IMF quite significantly. We would trace this difference to the following characteristics of Pakistan's economy, which are not meaningfully accounted for by the IMF:

- A significant black economy that often drives the formal sector;
- Household wealth is mostly undocumented and understated (in real estate), which drives spending patterns;
- A very small component of consumption is financed by borrowing (which could be sensitive to interest rates);
- The direct and indirect role of administered prices in the CPI basket (e.g. fuel prices, utility tariffs & transportation costs that are impacted by the PKR/$);
- The role of the PKR and retail fuel prices in price-setting behavior (retailers often use these factors to justify price increases); &
- The volume of government borrowing has little to do with interest rates. GoP will borrow what it needs irrespective of the cost.

However, debt servicing in FY19 will become much heavier compared to previous years when domestic interest rates were reduced in FY15 (see **Figure 1**). We also argue that a sharp PKR depreciation will unleash inflation, which in turn will force SBP to increase interest rates, which again will force the country deeper into a debt trap.

In the abovementioned papers, we suggest that orthodox IMF remedies need to be supplemented with out-of-the-box measures to increase tax revenues and curtail imports. In view of the direct impact on future debt servicing, this means the quantum of policy adjustments in FY19 (of both the PKR and interest rates) would have to be measured to narrow the twin deficits *without* stoking debt servicing and blowing-out the fiscal side. We made two suggestions: we urged that all real estate holdings be documented and more accurately valued (to enhance documentation and revenues), and that Pakistan should consider an element of import substitution with China via a revised Pakistan-China Free Trade Agreement (FTA).

The IMF's targets for the PKR and interest rates are internally consistent but, in our view, too high to narrow the twin deficits in FY19 and beyond (see **Box 1**).[5] At these levels, if the twin deficits are to be narrowed compared to the 12.4% of GDP realized in FY18, this would impose a level of fiscal contraction that will either shut down the government's social spending plans, or compel the GoP to set such high tax revenue targets (for the year), that it is highly unlikely that Pakistan will be able to achieve them. Breaching this fundamental target in the first year of a three-year IMF program, would be disastrous for the country.

Is anything different this time?

Most would say no, but being more optimistic, we think that the PTI's election campaign and the steps already taken to name Pakistanis with assets abroad, are promising first steps. Lists are circulating on social media, with names, addresses and contact numbers for thousands of Pakistanis with assets abroad. FBR has also sent notices to several hundred Pakistanis (many of them tax filers) who have been identified as owners of properties in the UK and UAE.

In our view, the IMF's suggestion that Pakistan must create a "fiscal cadaster" that digitally link all wealth holdings to individual Pakistanis, is not given its due importance. We have long argued that Pakistanis are much more affluent than official statistics suggest, and it is this hidden wealth that allows for consumption/investment patterns that the government has little control over. For policymakers to get a better handle on the economy, they must overcome this veil of secrecy. More importantly, once people have been publically identified, they cannot hide in the future. Furthermore, as the taxation and documentation drive extends its reach, the commercial activities of individual Pakistanis will be better understood.

It is still too early to say what will come of the PTI's accountability campaign, and the follow-up with those individuals who have been named. Legal proceedings and drawn out court cases are to be expected, as people on the list are powerful and well connected. The recent arrest of Shahbaz Sharif (the president of the PML-N and the leader of the opposition) for his alleged involvement in a corrupt housing scheme, suggests there will be strong political resistance to the accountability drive.

One must realize that each individual who has sent money abroad using the Hundi/Hawala system, has broken SBP rules. Furthermore, if the source of this money (in Pakistan) cannot be traced to documented economic activities, this may create an environment whereby some people may be willing to disclose details as part of the whistle-blowing provision that allows them to retain 20% of the asset values. This in turn, could expose more corrupt practices and ensnare more people within Pakistan.

We would argue that the gauntlet has already been thrown down. The issue is whether the PTI government has the gumption to carry this fight to its desired end.

What exactly are structural reforms?

This may appear an odd moment to talk about structural reforms, but the likely resistance to the anti-corruption campaign (which will invariably take on a political dimension), suggests that it is *also* a

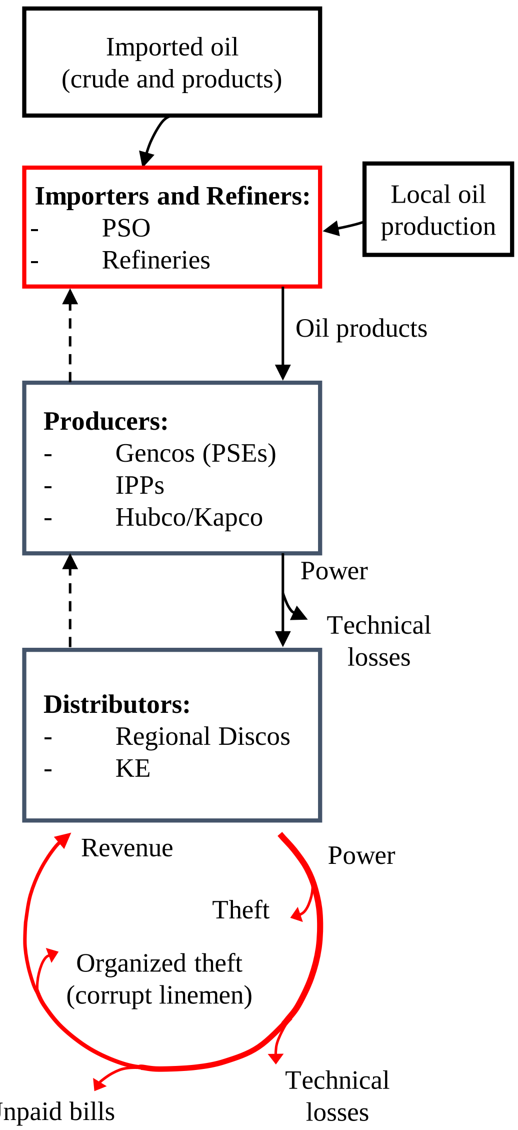
[5] In an article on 13 October, the *Express Tribune*'s Shahbaz Rana claimed that during the discussions in Islamabad in early October, the IMF team had suggested that the PKR needed more flexibility, and that stabilization measures would push inflation to around 14%, which would require SBP to take interest rates to 15% (12.5% in the short-term). In our view, a parity around Rs 138-139/$ by end-June 2019, that pushes inflation to 8-9%, would require a benchmark interest rate of 10% at the end of FY19. A 300 -500 bps difference in the level of interest rates can have a huge impact on Pakistan's fiscal side in FY19.

structural reform. To better understand the issue, one must realize that economic reforms boil down to changing individual behavior. For example, enforcing the accountability drive of Pakistani assets held overseas, entails the following end-goals: (1) to deter such behavior in the future; (2) to close down avenues of capital flight; (3) to signal that individuals will not be able to "invest" their ill-gotten gains; and (4) to eventually force affluent Pakistanis to disclose all their sources of income.

After decades of prioritizing one's own interests, these behavioral changes will not be easy. To better appreciate the likely resistance to such economic reforms, we will use the circular debt problem as an example.

Chart 1 is a stylized illustration of the power sector. In simple terms, the circular debt (estimated at Rs 1.2 trln) is created because of the difference between the cost of generating and distributing power, and the revenue realized by the sale of this power. As shown, oil importers (primarily PSO) and refineries channel oil products to power generators, which generate power and transmit it to distributors (Discos). The cost of this power (i.e. what the Discos owe the producers) is often far higher than what the Discos receive from customers. Hence, Discos create *payables* (payments that need to be made in the future) to producers which, in turn, have no choice but to create payables to PSO and refineries. If the hemorrhaging becomes too acute, PSO is unable to import as much oil as needed, which reduces the generation and distribution of power. This results in load-shedding in the country.[6]

Chart 1: The Circular Debt Problem



To understand the reasons for the circular debt, experts claim that about half is because the government does not increase end-user tariffs to cover the cost of providing this power, while the other half can be traced to inefficiencies within the Discos. As shown in **Chart 1**, a significant portion of the power that is distributed by the Discos is: (1) lost to pilferage (i.e. outright theft); (2) lost because of technical losses (poor and archaic hardware); (3) lost because of unpaid bills (customers simply refuse to pay their bills but still get power); and (4) lost due to organized theft (where linemen collude with customers). As a result, the revenues generated by the Discos are only 70-80% of their costs, with the difference pushed upstream in the form of payables.

[6] To keep the system running, commercial banks step in to finance PSO, the refineries, IPPs and Hubco/Kapco – banks are unwilling to lend directly to Discos or state-owned Gencos. This bank financing is a short-term fix and not a solution.

Despite the perceived complexity of the circular debt problem, the solution is very simple. Bankers who manage the circular debt problem, have suggested the following steps to arrest the growth of the debt – going from the most important to the least important:

1. Increase end-user tariffs to ensure that the *Tariff Differential Subsidy* the federal government must budget for, is brought down to zero;
2. Change the billing/load-shedding strategy, so that private consumers who pay regularly are provided power, and those that do not pay are denied power;
3. Replace/upgrade the hardware used to transmit and distribute power. This may require heavy upfront investment, but it should help curtail technical losses which are quite significant in some Discos;
4. Stop supplying power to chronic non-payers in the public sector (e.g. FATA, provincial governments and affiliated bodies, etc.);
5. Eliminate political interference that determines who gets power, and who doesn't. Discos are strongly influenced by provincial governments and political agents, whereby favored commercial entities are given access to uninterrupted power, but others are not. This corruption is enforced by ground staff (linemen) who are often affiliated with various political parties;
6. Create a heavy-handed enforcement team that targets the outright theft of power; and
7. Change top-management and the board of directors in the Discos.

In implementing these changes, one can imagine the political opposition. Increasing tariffs will be challenged on political grounds and result in public demonstrations; cutting off power to non-payers (many of them being government agencies) will create an uproar in provincial assemblies; stopping the abuse by bulk users will be opposed on charges of discrimination against "less privileged" users; keeping load-shedding decisions insulated from political agents, will require tremendous effort within the Discos; and creating an enforcement team to stop theft could lead to violent clashes with local mafias that have political patronage.

Getting people to change their behavior and accept the new rules of the game, is a very tall order. This explains why hard economic reforms have not been implemented in Pakistan. Returning to the earlier issue, if the accountability of affluent Pakistanis is pursued rigorously, this will surely create a unified opposition. This coalition of businessmen, land-owners, bureaucrats, senior military figures, politicians and political agents, will take a purely economic issue (theft, non-payment of bills, etc.) and spin it into a political crusade. More simply, the theft of electricity will not be projected as outright theft, but as a concerted effort (by the government) to victimize an ethnic group or a specific political party.

Disruptive reforms

In our view, *if* the PTI government has committed itself to the accountability drive, it should prepare itself for more comprehensive structural reforms. As discussed earlier, resistance is likely to be fierce, but the political mandate of this government and the current global environment, create a unique opportunity to take these decisive steps. Structural reforms are not easy, and unlike previous governments, these steps should not be taken in a *business-as-usual* approach.[7]

In *The Parable of Pakistan and the IMF* (27 December 2016), we argued that the regularity with which Pakistan has been approaching the IMF, creates a sense of familiarity that undermines the chances of successfully reforming the economy. In other words, since Pakistan has been trying to implement the

[7] This would also suit the IMF, as the last program has been criticized for the generous waivers granted by it for missed targets. The recent US pressure on the IMF regarding repayments for CPEC, will keep this multilateral on its toes. In our view, stern statements from the IMF about mismanagement by Pakistani policymakers, would certainly help.

same reforms with the *same* partner (the IMF) for nearly three decades, this creates a business-as-usual mindset on both sides, whereby our policymakers will go through the motions of reforming, but shy away from the hard stuff. In our view, if economic reforms stand any chance of succeeding, they must be disruptive and entail a political struggle.

What needs to be done?

To lump the needed policies into goal-driven endeavors, we would suggest the following areas:

1. Power sector viability;
2. Documentation and revenue generation;
3. External sector sustainability;
4. Industrial policy; &
5. Regulatory and institutional strengthening.

1. Power sector viability

It's not just about the stock of circular debt, but also dealing with the power generation projects that have been initiated as part of CPEC. More specifically, the government would have to increase end-user tariffs to eliminate the *Tariff Differential Subsidy*, while top management in the Discos would have to be given sufficient political cover to defy internal and external pressures against reforms (this applies to both, the Board of Directors and senior management).

For their part, the federal and provincial government should enforce strict energy efficiency in all their offices and affiliated agencies. These governments and agencies should also adopt direct debit, whereby their power bills are automatically deducted from the bank to pay the Discos. Local and provincial governments should also launch public awareness campaigns about power theft, and create a publically supported enforcement system to dismantle organized and opportunistic theft (see **Chart 1**).

2. Documentation and revenue generation

Everyone in Pakistan is aware of the existence and scope of the undocumented economy. Many businessmen simply refuse to document their operations, and feel no fiduciary responsibility to pay taxes. This mindset needs to be corrected, not just via a public awareness campaign, but with concrete steps that leave non-filers with no option but to enter the tax net. This dovetails with the IMF's fiscal cadaster, which is a digital ledger of all assets in the country (e.g. real estate, bank accounts, automobiles, etc.) and their beneficial owners. Pakistan's NADRA system has the reach and capacity to make this possible.

We would also suggest that the previous government's real estate valuation initiative (launched as part of the Amnesty Scheme) be taken forward forcefully. As we have argued in the past, as much as 80% of Pakistani wealth is kept in real estate (especially in undervalued, empty residential plots), and this wealth will only be revealed if all real estate assets in Pakistan are accurately valued. This will require the federal government to carry the support of all provincial governments, as this initiative would have to be taken across the country simultaneously. As discussed earlier, efforts to identify Pakistanis with overseas assets should continue as a policy priority, to regularize these assets into the owner's tax records.

To plug further leakages of hard currency from the country, SBP's proposed amendments in FERA and PERA should be pushed through parliament. Ideally, this should *disallow* cash transactions in hard currency, not just to discourage Dollarization, but also to halt the transfer of these funds out of the country. This is likely to be resisted by most members of the affluent class, but is necessary to ensure that currency notes brought into Pakistan (a sizeable daily quantum) are channeled into the interbank market, and not used for capital flight or to finance cash imports.

With a fiscal cadaster in place; more accurate valuation of real estate holdings; and penalties against tax non-filers, we are confident the government will generate higher direct tax revenues. Just the act of forcing people to file their tax forms, is a significant step forward.

3. External sector sustainability

The PKR adjustments and increase in domestic interest rates, are necessary but not sufficient to stabilize the economy. As we have been arguing since May 2017, Pakistan needs to implement more customized reforms, and in the case of the stubborn external sector deficit, Pakistan's trade/investment relationship with China requires a reset.

This is not so much about CPEC, but more the Pakistan-China FTA – the good news is that the Chinese government has shown its willingness to renegotiate the FTA. Given the media controversy surrounding CPEC, and the previous government's inability (unwillingness) to fully explain CPEC's impact on Pakistan's economy, we wholeheartedly endorse the need to make CPEC details more accessible and transparent. Only an informed public discussion about CPEC will put to rest the more negative assessment that is gaining traction. The only suggestion we have, is that future CPEC projects should focus on increasing Pakistan's exports and/or creating new jobs in the country.[8] Having said this, if there are credible claims that some CPEC projects involve kickbacks, they should be investigated as part of the accountability drive.

A final point is import substitution. While this is an unpopular topic with most economist (and so called *practical men* – **see Box 1**), we believe that Pakistan should look into this strategy to narrow the growing trade deficit with China. CPEC's vision to create industrial cities along the China-Pakistan land-route, should be customized to manufacture those goods that are currently imported from China. With the growing use of trade protection, and a US president who prefers bilateral trade deals to multilateral agreements, Pakistan is not likely to be criticized for import substitution.

4. Industrial policy

The goal here is to create jobs. We have long argued that a country of Pakistan's size, must have a viable manufacturing base. The local market is big enough to justify large scale manufacturing, and Pakistan's population demographics require a regular stream of new jobs. In our view, CPEC is ideally positioned to facilitate this endeavor. In fact, in an earlier paper (*Does Pakistan need an Industrial Policy?* 5 January 2017), we argue that CPEC is almost a blue-print for Pakistan's industrial policy.

We would also propose that Pakistan's loss-making PSEs (e.g. PIA, Pakistan Railways, Pakistan Steel Mills, etc.) be restructured within the backdrop of CPEC and Pakistan's industrial policy. One of the founding goals of CPEC is to create training institutions for Pakistani workers and to establish industrial cities. As we have discussed before, the political opposition to restructuring these PSEs will be fierce. To counter this, the government should appeal directly to the workers who are fully aware that they have dead-end jobs; if they are told they could secure more productive jobs and will be trained for them, they may support the restructuring. In our view, surplus workers in overstaffed PSEs need hope, and the government should try to address their anxiety.

5. Regulatory and institutional strengthening

In Pakistan's commercial circles, a common complaint is the lack of policy implementation. Many will agree that Pakistan has the right policies in place, but these are either skirted or poorly implemented. In

[8] The previous government was stubbornly focused on power generation (not transmission and distribution), which has strongly shaped what CPEC now looks like. This misguided emphasis must change, and the current needs of the country should shape how this ambitious project evolves.

our view, it's not that simple. Implementation is the responsibility of regulators and affiliated state institutions, and while we have argued that political interference undermines the functioning of these institutions, we believe these institutions are now too weak to carry out their responsibilities.[9] With compromised senior management and rubberstamping boards, state institutions need to be rebuilt from the ground up. This is necessary not just for them to wield their autonomy with confidence, but also to use their institutional history to better guide elected ministers.

In the current environment, we would not limit restructuring to only those institutions that manage Pakistan's economy (e.g. SECP, SBP, FBR, PBS, Finance, Commerce, Industry, the Planning Commission; NEPRA, OGRA, etc.), but also include investigating agencies like NAB and the FIA. In our view, the credibility of the accountability drive and the effectiveness in reaching end-goals, will be enhanced by strengthening these institutions.

Oversight of structural reforms

In assessing the reasons that reforms have not delivered results in Pakistan, several issues keep cropping up: governance; rolling back reforms by allowing exemptions; poor implementation; coordination failure within the government machinery; and the lack of public interest.

As we have illustrated with power sector reforms, the changes required entail a heavy political price, and both the bureaucracy and elected ministers will shy away from rocking-the-boat. In an insightful op-ed by Khurram Hussain in *The Dawn* (*Reforms and Reformers*, 27 September), he argues that the bureaucracy intentionally diverts ministers away from hard reforms by putting forward such an urgent set of policy actions that the new minister's focus on reforms is quickly extinguished. In some cases, the "required" actions contradict the reforms themselves. The bureaucrats will then use this misstep to discourage further steps along the reform path, claiming this would be criticized as being inconsistent and would taint the minister's reputation.

This is done as the bureaucracy itself is complicit, and would like to retain policies that suit Pakistan's moneyed interests. Behind closed doors, hard reforms are discouraged by playing up the resulting political costs and economic disruption, while media management is tweaked to give an impression of progress.

In our view, each of the five abovementioned endeavors, should be spearheaded by a specific Czar with executive powers. This person should be avowedly apolitical and a seasoned professional – he/she should not be from the government, nor should he/she report into the government. An Oversight Council should also be created (see **Chart 2**), to specifically monitor how these structural reforms are being implemented, and report their progress directly to the PM.

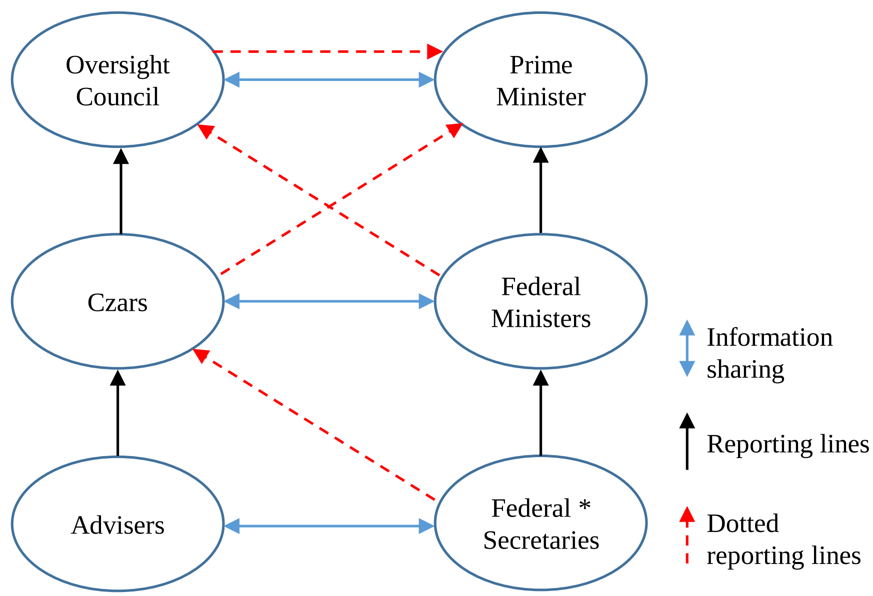
This structure should not be viewed as replication, but an effort to ensure that critical reforms are pursued with commitment and rigor. More specifically, the Czars could share the work burden with Federal Ministers to ensure that reforms are: (1) not impeded by inter-government coordination problems; (2) closely monitored with a specific focus on political opposition; and (3) given a public face, whereby the "crusading" Czar maintains a public interface to update the country about progress – or lack thereof. The latter will give media and social media a handle on these structural reforms, and specifically highlight

[9] For example, the quantum of external borrowings in FY17 and FY18; the almost fixed PKR/$ parity from early 2015 to late 2017; the lack of policy attention on the transmission and distribution of power (while the GoP continued to build generation capacity); the increasing losses posted by PSEs; and the fact that the number of tax filers has not increased much in recent years, are stark reminders that the bureaucracy is either unable or unwilling to put things right.

those groups that are impeding economic reforms. It should be said, that while these functions are helpful for the reform process, the Czar's main task would be to act as a check on senior bureaucrats.

Since structural reforms are politically difficult, the only chance of success, is to gain the support of the general public. So instead of viewing reforms as requiring/using scarce political capital, this could be an avenue to generate *fresh* political capital. In our view, this would also allow the government to justify the painful measures required to stabilize the macro economy. This alternate governance structure is perhaps necessary to oversee Pakistan's bureaucracy, and will certainly create the impression that this is not business-as-usual.

Chart 2: Alternate Government Structure



*And equivalent in regulatory bodies.

Concluding thoughts

None of this will be easy.
In our view, the key ingredient is the mindset with which the government approaches these economic challenges. As we have argued, a business-as-usual approach towards economic reforms is a sure way to ensure that nothing good will come of it. Structural reforms are by definition disruptive, and should be managed as such. Since the resistance to change is likely to be couched in political terms, the government must prepare itself for this political battle. There is an upside: if the government formulates a successful political strategy to handle the first set of reforms, it should open up multiple fronts – more simply, the government should take on the five goal-driven reforms simultaneously, and use the same narrative to fight back.

This may appear risky, but it will certainly signal intent and dispel any impression that this is business-as-usual. This is important: while the status quo will gear up to resist and frustrate the government's efforts, traditional and social media could cultivate a support base for reforms. If the hypocrisy and self-serving nature of state institutions is exposed, it could create public appetite to push ahead despite the economic disruption. PTI's support base would also feel vindicated, especially after the slow and hesitant start.

Pakistan's economy is largely portrayed as *going back to square one* – i.e. returning to the IMF. However, in view of PTI's campaign promises and the steps taken to identify Pakistani assets overseas, the government has taken a significant step forward. If the government can formulate a political strategy to take-on the moneyed interests, we feel this could tip public opinion in its favor. If the general public (which we believe is already fed-up of corrupt and inefficient state institutions) backs this reformation, Pakistan's economy may finally be on the mend.

This could make the next IMF program our last.