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IMF and CPEC

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The IMF Staff Report on the 8th Review of the Extended Fund Facility to Pakistan was released two days ago. This report duly recognizes the importance of CPEC and the potential contribution it can make in the medium run to enhancing productivity and growth in Pakistan.

Based on figures provided by the Government, IMF indicates that the overall investment under CPEC is about $45 billion. For energy projects the outlay is $33.8 million, equivalent to 75% of the total. The remainder, $10.6 billion, will be devoted to transport infrastructure.

IMF has been informed that all transport projects are expected to be completed by 2017-18. In addition, priority projects in the energy sector, which will create IPPs, are scheduled to add 10000 MW by 2017-18.

According to the Fund, financing modalities will differ. Transport infrastructure projects will exclusively be financed by government-to-government longer-term loans on concessional terms. Energy-related projects will be in the nature of foreign direct investment (FDI), financed by commercial loans from Chinese financial institutions to Chinese investors in Pakistan.

The IMF statement on CPEC clearly states that the transport infrastructure projects 'will be executed within the overall envelope of the public sector development program (PSDP).' Further, the Fund expects the Government to 'prioritize the infrastructure project execution such that they remain within an overall fiscal envelope aimed at gradual debt reduction.' As such, it emphasizes that potential fiscal risks will need to be mitigated.

The Fund has in a subtle way signaled its concerns on CPEC. The basic issue is one of the 'fiscal space' to absorb the CPEC infrastructure projects.Clearly, there will need to be a big hump of public investment due to the CPEC in 2016-17, 2017-18 and thereafter.. Already, in 2015-16, 16 projects of the Railway and the National Highway Authority have been included in the Federal PSDP. The combined cost of these projects is almost Rs 334 billion. An allocation of approximately Rs 16 billion has been made to these projects for the current year.

The rise in public investment in the next two years will necessitate a big increase in federal PSDP and a corresponding upward adjustment in the size of the fiscal deficit. On the assumption of 40% implementation in 2016-17 and the remaining 60% in 2017-18, the allocation for CPEC infrastructure projects will have to be close to Rs 440 billion and Rs 660 billion respectively in the next two years.

Based on the same pruning in allocations to on-going projects, the PSDP at the federal level will have to be larger by at least Rs 350 billion in 2016-17 and by almost Rs 550 billion in 2017-18. This will imply a jump in the level of government investment by approximately 1.2% of the GDP in 2017-18 and 1.7% of the GDP in 2018-19.

The latest Medium Term Economic Framework prepared by the IMF, after the 8th Review, makes no provision for a big rise in government investment in the next two years, from the projected level of 3.8% of the GDP in 2015-16. In fact, a significant drop is proposed in 2016-17 to 3.4% of the GDP, rising somewhat to 3.6% of the GDP in 2017-18.

Does this mean that the Fund is expecting the PSDP allocations to on-going projects to be cut back drastically over the next two years or for the implementation of the vital transport infrastructure projects to be staggered over a longer period? Either option is unacceptable.

There is need for the Ministry of Finance to emphasize to the IMF mission during the forthcoming review that the present medium-run macroeconomic framework is inadequate. The projected level of investment by government in 2016-17 will have to be raised from 3.4% to almost 4.6% of the GDP and in 2017-18 to 5.3% of the GDP. There will also have to be a corresponding increase in the projected fiscal deficit from 3.5% to 4.7% of the GDP in 2016-17 and from 3 to also 4.7% of the GDP in 2017-18. The present IMF program comes to an end in September 2016. It is absolutely essential that at least for 2016-17 the relevant projections are revised upward.

There are other implications. Imports will be larger of machinery and materials, financed by larger foreign (Chinese) assistance or FDI. Public external debt will rise at a faster rate, by almost $11 billion by 2017-18.Commercial borrowing for power projects will add substantially to private sector external debt.. None of this has been factored into the medium-term projections contained in the 8th Review report.

There is no doubt that the CPEC is a potential ‘game changer’ for Pakistan. No limitations must be imposed on either the size or pace of its implementation. This has to be made clear by the Government to all agencies.

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