

The Impact of IMF Loans, Programs & Compliance With Conditionality on Economic Growth in Pakistan



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CERTIFICATE

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Author's Declaration

I, **Salman Tahir**, hereby state that my Masters of Philosophy thesis titled, “**The Impact of IMF Loans, Programs & Compliance With Conditionality on Economic Growth in Pakistan**” is my own work and has not been previously submitted by me for taking any degree from Pakistan Institute of Development Economics or anywhere in the country/world.

At any time if my statement is found to be incorrect even after my graduation, the university has the right to withdraw my M.Phil. degree.

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While writing this section I still do not believe I made this far. A time came when I had finally decided not to pursue my degree further, even after completing my coursework. This is the reason I completed this research after 2 years owing to a demanding job and my mother's illness. Nonetheless, I succeeded and it was not possible without support and guidance of two people. Dr Javed Iqbal, who was my supervisor initially but had to discontinue due to a new policy by the university administration as we could not hire outside professors as supervisors. Secondly, my subsequent supervisor, Dr Ahsan ul Haq Satti, who worked tirelessly with me and went beyond way. This study is a product of his guidance, support and motivation.

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Abstract

The Asian IMF Programs of 1997 failed while that of post 2008 recession were a resounding success. Taking idea from this observation the study attempted to look into how IMF Loans, Programs and Compliance with Conditionality affect growth in Pakistan. Both programs and loans are disintegrated because loans capture the money component and programs capture the advice channel through which IMF can influence a country. Taking idea from Dreher (2006) we used a Seemingly Unrelated Regressions model and our results show that IMF has a negative effect on growth in the country. However, it couldn't be ascertained whether compliance with IMF conditions mitigate this negative association or not since the coefficient was insignificant. Also, it was discovered that as opposed to literature IMF programs in Pakistan usually take place in democratic regimes. One of the major reasons could be geostrategic, as due to Afghan War and Post 9/11 autocratic regimes had huge influx of aid and support from the Western World. Future research should focus on capturing compliance in a better way and how IMF programs specifically target poverty and welfare spending. At large the study focused mainly on IMF and we found that IMF's policies aren't any favorable either. But like it is always said the solution always lies within. What could it be? Capital Controls? A national consensus on economic affairs? This is an arena to be assessed in future studies but our policy makers seriously need to give heed to the fact that something novel and different needs to be done now. The oft-repeated going to IMF is like going again and again to the same doctor whose remedy did not work previously.

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Chapter 1

Introduction

1.1 Background and Motivation

John Maynard Keynes was one of the founding fathers of International Monetary Fund but (Zaidi, 2005) in a chapter mentions that Keynes would be rolling over in his grave to see what happened to his brainchild (IMF) and this became the primary motive to dig deeper in this regard. After the Great Depression of 1929, it was realized that as opposed to the belief of the Classical School, an increase in money supply does not merely increase price level but affects the real economy too and this led to the emergence of Keynesian School of Economics. Keynes then went on to become a founding member of IMF and World Bank and envisaged that IMF should help countries in recession and help bring financial stability. However, over the years the role of IMF has drastically changed. (Zaman, 2015) thus, rightly questions that on one hand, IMF is of the opinion that fiscal deficits if financed with increase in money supply can accelerate inflation and lead to a heavy economic cost. But on the other, Keynes argues that money supply should be increased in economies with high unemployment. Zaman thus argues that (as per Keynes) in this situation increasing money supply is not inflationary; questioning who's right: Keynes or IMF?

Moreover, the statement by Former Brazilian PM, when visiting Spain amid the global financial crisis also caught my attention. The Former PM and economist say that the model of austerity which was previously called adjustment had bankrupted the Latin in 1980s. She says that no good can come from it if there are no incentives for growth and investment. Hearing and reading this, I decided to start my quest and find out why is Pakistan in this evil spell of bailouts and should IMF be blamed for it? After reading (Takagi, 2016) I got more eccentric

as the author argues that both the Asian programs of 1997 and European programs of post 2008 were similar in nature, yet the former failed and the latter to a great extent were successful. All these led me to dig deeper in this regard and ascertain whether is Keynes right or IMF, and whether the Brazilian PM's statement and Takagi's analysis have any lessons for Pakistan?

The motivation behind this topic has already been revealed but my interest in the topic developed after taking a course in Pakistan's Economic Policy. (Zaidi, 2005) was very instrumental in clearing doubts about the role of IMF and the modus operandi of its operations. A very startling thing that emerged during this course was that over the years a populist narrative is that bailouts to IMF have further deteriorated our economy but upon assessing our country's history with IMF it was discovered that our rate of program completion is very poor. Since the past 30 years or so we have made reaching to IMF as more than a habit and it needs to be ascertained whether IMF programs proved as a boom or bust. Therefore, it is more important to find out the impact of IMF's conditionality and the extent to which it was implemented in Pakistan. As discussed earlier too, the comparison between IMF and Keynes, and Shinji Takagi and Brazilian PM further motivated me to pursue the topic. Hence with this eagerness in mind I moved on to the following problem statement:

1.2 Problem Statement

The IMF was founded with the aim of providing support to its member countries in financial distress but (Dreher 2006) with a sample of 98 countries found that IMF programs decreases economic growth. What is astounding is that compliance with conditionality as revealed by him mitigated this negative effect, but the overall impact on growth was still negative. This study tends to assess the findings of (Dreher 2006) in the case of Pakistan by including the recently ended programs of Pakistan. Hence assessing the impact of IMF growth and the other strand of literature, compliance with conditionality, this study aims to assess past

programs and if in the past programs non-compliance is witnessed what else can be the reason for our economic woes? Moreover, I also intend to separate the effects of IMF channels of IMF that can influence an economy, thereby separating the effects of loans and money disbursed. To add weight to my findings I will conduct a before-and-after analysis and a case study approach of each IMF program post 1988.

1.3 Objectives

This study is aimed at looking into the effects of IMF programs on Pakistan's economy. Also to see how in the different regimes IMF programs played their part and what caused a poor completion rate. Hence the objectives of this study are:

- To find out what are the determinants of IMF loans and IMF programs in Pakistan, so as to disintegrate the two ways in which IMF influences a country.
- To ascertain whether compliance with conditionality results in a change in the growth rate.
- To assess the effect of loans, programs and compliance with conditionality on growth in the country.

1.4 Research Questions

- What are the determinants of IMF loans and programs in Pakistan?
- Has compliance with conditionality of IMF programs resulted in any change in the growth rate?
- Combining IMF loans, programs and compliance with conditionality, what is the effect of IMF on growth in Pakistan?

1.5 Organization of the study

Section 1 starts with an introduction of the study revealing the motive and motivation behind this study with further unveiling the problem statement, and the research questions to be assessed. Followed by the objectives and questions, the next section proceeds to analysis of past literature on the subject. After the discussion on evaluation of past literature the gap of this study is revealed. Section 3 discusses data and methodology and Section 4 analyzes results of the empirical results. Section 5 concludes with giving a policy implication.

Chapter 2

Literature Review

This section is divided into:

- Analysis of past literature with the study gap at the end
- Conceptual Framework
- Before and after analysis

2.1 Analysis of past literature

2.1.1 Background

On 27th December 1945 the International Monetary Fund was founded with the aim of helping its member countries achieve economic stability in order to avert crisis like that of the 1930's Great Depression. Over the years, the focus of IMF remained fostering financial stability but with the changing economic trends added sustainable economic growth and reducing poverty to its list of aims and objectives. Henceforth, any of the 189-member country which finds itself in financial distress reaches out to the Fund and secures a loan with some set of conditions to comply with. However, the conditions attached, in various cases, lead to further worsening of the economic conditions of the borrowing country and the borrower ends up with piles of debt accumulated.

The case of Pakistan is no different and the Pakistani economy can be compared to an old school bus. Whenever the bus accelerates at a high pace, the engine heats up but if the driver drives it a slow pace, the bus has a relatively smooth ride. The Pakistani economy is no different; in the past 18 years at least, we have witnessed that whenever our economy achieves a high growth rate, our fiscal managers further increases spending which leads up to the extent of a fiscal deficit. The fiscal deficit then translates into a balance of payment

deficit, hence creating a situation of twin deficit. This heating of economy is similar to the old school bus which heats up when driven at a high speed. Resultantly, our government reaches out to the IMF, and since 1958 we've been doing that but the concerning thing is that since two to three decades our every successive government have made it a habit. Is IMF to be blamed for our inability of turning around the state of economy or does the problem lies within? A question arises that with being constantly under IMF Programs what decision making autonomy do our economic policy makers have? So the question lies, does IMF programs affect our economic growth and an even more important question remains: does compliance with conditionality have any effect on our economic growth? These are the targets of this study which will be tested empirically but before that an analysis of past literature is pertinent.

2.1.2 Early studies on IMF conditionalities

Measuring compliance with conditionality is an uphill task and many earlier studies used IMF's internal documents and one such study, which in my view is the first to do so was (Beveridge & Kelly, 1980). The study analyzed 105 programs in different countries from 1969-78 with a focus on fiscal performance and reached the conclusion that 60% of the programs complied with fiscal deficit targets and 54% with credit ceiling. Similar results were found by (Nsouli & Zulu, 1985), as they found poor fiscal targets and half of the African countries under study complying with the fiscal targets. (Polak, 1991) continued the trend by reporting that his empirics reveal that compliance with credit and fiscal targets remained 40% for the 17 Structural Adjustment Facility (SAF) programs studied, while for the Enhanced Structural Adjustment Facility (ESAF) programs the compliance percentage was 60. This study, however, is a masterpiece on theory of conditionalities. But before coming in detail into that let's first ascertain the meaning of conditionality.

According to (Gold, 1979) conditionality is a set of policies which IMF expects a member country to follow in order to qualify for credit. Over the years the clientele of funds has changed drastically as in the first two decades of its creation, half of the loans were given to industrialized countries. But since 1980s when the process of transition to market economies gained strength and industrialized countries looked towards international capital markets for finances, the Fund devoted its monies particularly to developing countries. Interestingly, in the course of these years the nature of fund's conditionality and focus has changed. Where it was solely on balance of payment support earlier, the focus then evolved into arena of growth and that pretty much describes why the Fund's conditionalities have become more rigid. It is debatable however whether the conditions do achieve the growth and sustainability objective or does quite the opposite. However, exploring the theory of conditionality and coming back to (Polak, 1991), the study goes on to explain that two sets of instruments lays down the framework which govern implementation of Fund's desired policies or simply what we have been referring to as conditionalities. First, is the letter of intent to IMF, which highlights the outcome of conclusion reached between a member country and the IMF. Secondly, PFP (policy framework paper), which is an instrument in fund-member duo relations which mentions broadly the course of action of three years and in-depth details of modus operandi of economic affairs in the following year. This document too is prepared after joint consultation between a borrowing government and IMF/World Bank.

Moving ahead, the committed policy actions can be relaxed if a borrower initiates "preemptive actions". This means that Fund's conditionalities are decided keeping into consideration prior actions of the borrower. The Pakistani government which came into power in 2018 is doing similar things, be it increasing utilities prices, slashing subsidies or imposing new taxes, and (Stiles, 1990) argues India's 1982 IMF program was initiated with preemptive reforms which led to a decrease in IMF's leverage power. Therefore, prior actions

are an important component of the program, followed by the performance criteria set which is assessed in the quarterly, bi-yearly or yearly review depending on the program in action. Returning back to (Polak, 1991) it is important to extract his distinction of the Fund's primary and secondary objectives of conditionality and where his assertion of primary objectives as balance of payment adjustment, economic growth and price stability is understandable as it is in practice even today but the debate of a situation of conflict between growth and adjustment is something new for me. The Fund though pushes both for growth and adjustment at the same time but whenever there is a conflict between the two the study proposes that not these two be considered but growth today versus growth in the future be regarded. Citing the example of Peru, the study highlighted that Peru stoked its growth and achieved a 9% rate in 1986 and 1987 but in the following years (i.e. 1988 and 1989) ended up with -9% and -12% growth rate. Hence growth in the future is more important than shiny numbers today and that has been the case even in Pakistan. Since 2008 every successive government initiates a mix of adjustment and growth strategies but when they are about to transfer power to the next government all their tall claims of progress disperse in thin air. Besides this, as contrary to the common belief IMF has some pro-poor and social objectives too, in its list of secondary objectives of conditionality. The study lists it as steps towards poverty alleviation, mitigating the environmental damage, containment of military expenditures and added political consideration (referring to exceptions where the Fund's technocratic decision is influenced by powerful world players).

2.1.3 IMF Programs and Economic Growth

Moving on to more recent studies, (Dreher & Vaubel, 2004) undergoes a very interesting study on IMF's conditionality and lending and arrives at a positive relationship conclusion between the number of conditions per program and the past use of IMF's credit relative to quota. After constructing a public choice model, the study moved on to empirical tests by

using an instrumental variable technique employing 2SLS method. Drawing a demand curve for borrowing countries they argued that the demand for IMF loans shift when a borrower moves into recession, experience a decline in her products' orders globally, stick with a fixed exchange rate regime and that too with an overvalued currency, increase spending or monetary expansion due to elections or face high interest rates in the global capital markets. However, it is important to note that IMF's conditionality moves with certain worldwide developments, i.e. conditionality rises when: international reserves decrease, interest rates rise in international capital markets, the borrowing country experiences monetary expansion and when the number of world bank adjustment loans increase. Studying 206 letters of intent from 1997 to 2003, they found that the number of conditions does not influence any of their target variable and instrument. Finally, the study assessed IMF's conditionality with tied transfers' literature. In IMF loans' case transfers refers to the difference between IMF's interest charge and the charge levied in capital markets, i.e. the interest subsidy provided by IMF. The study states that a great number of economists criticize tied transfers because it prevents recipient countries from maximizing their utility (problem of moral hazard); however, defenders of the practice claim that the strings attached enable recipients to use the facility in the best possible manner. And when the same literature is linked to IMF's conditionality, the study concluded that lack of conditionality may lead to problem of moral hazard but conditionality itself isn't the sole solution. The conditions in practice are not very result bearing and should be less in number, simple and target the instruments they control and not the targets which are out of their reach. Besides this, moral hazard can be avoided if IMF changes its review to ex ante as opposed to ex post. Another similar study by (Blackman & Unigovskaya, 2004) studied the effect of compliance with conditionality of transition economies in 1990s on the output recovery by using the structural benchmarks and performance criteria.

Structural benchmark (SB) refers to the activities a borrowing country must initiate to enable structural adjustment and fix its macroeconomy for the long term, whereas performance criteria (PC) refers to floors and ceilings imposed on macroeconomic variables and complying with them leads a country on the path of macroeconomic stabilization. PCs are more or less the same for every program while SBs vary with every country's needs.

Using IMF's Database for Monitoring Fund Arrangements (MONA), Blackmann's study found no evident relationship between structural benchmarks and economic growth. Nevertheless, a very startling evidence emerged that countries which successfully implement fund programs are likely to experience sustained growth of real GDP for three or more years. However, the reason for this finding was not clearly ascertained and the authors speculated that it may be due to a situation when taking ownership of a program leads to better results. Taking idea from this piece of literature one can assume why IMF programs proved to be a disaster in Pakistan as in our decades long relationship with the IMF, our compliance rate has been very poor. Even after our recently completed program (2013-17) which due to completion qualifies as being a compliant program our growth took a downfall and reasons for this development is yet to be looked at. However, coming back to (Blackman & Unigovskaya, 2004) using the MONA database is full of shortcomings and may not depict a clearer picture. This is primarily since MONA database overstates compliance by excluding programs that are permanently cancelled or interrupted and hence a better measure of compliance is required.

As I write this analysis of past literature, the news of Pakistan entering into a new EFF program came. Staff level dialogue has successfully ended and now the approval of IMF board is the next and final stage. In this environment of IMF re-emerging on the economic front of Pakistan, the study of (Vreeland, 2006) is an important piece of literature to look forward to.

Vreeland asserts that IMF loans end up subsidizing those bad policies of the recipient countries that had caused a crisis in the first place. His study is aimed at giving a policy implication that IMF program compliance should be assessed by looking at disaggregated measures of compliance instead of aggregated ones. His finding, in my opinion, is very valid but I think in Pakistan's case aggregated measure of compliance is still justifiable to use because the disadvantages of aggregated measures of compliance (which he gave) do not stand validated in Pakistan's case. This will be discussed ahead in detail.

The author of this study says that, on one hand, critics like (Stiglitz, 2002) is of the opinion that IMF programs deepen economic crisis in a country; on the other, those like The Meltzer Commission asserts that conditions attached to a program are at large ignored and the loans end up subsidizing policies which have at first place caused the crisis. He says that at the core of these two situations lies the question of compliance which if properly addressed can answer whether IMF programs prove as a boom or bust. But even before that let's move back to scratch and discuss the modus operandi of how an IMF program is initiated (we will move step by step which will lead to a more vivid picture of the problem in question).

IMF in simple terms is like a credit union with over 97% of the states in the world as its members. Each country, according to its size and other factors pool in money in the Fund from which the economically distressed ones get loans, particularly for balance of payment support. Nonetheless, IMF gives its subsidized loans with some recommendations that a borrowing country has to follow, commonly known as conditionality. The process starts when conditions mutually agreed by the finance ministry and IMF staff are sent to the IMF board for approval. This is sent by executive authority of a country in Letter of Intent (introduced earlier). Upon approval of IMF board a borrowing country is subsequently paid part of the loan and the rest is paid in tranches if the mutually agreed conditionalities are met. Simply put, an IMF program has two components: loans and conditions and the conditions

are aimed at making structural changes in the form of tightening monetary policy, increasing taxes, slashing and curbing subsidies, privatizing state owned entities and so on. Beyond this, domestic and international politics also influence these programs, as is revealed by several studies such as (Easterly, 2005), (Dreher & Vaubel, 2004), (Vreeland, 2006) and (Dreher, Sturm, & Vreeland, 2009) so on. In the international arena, powerful member states such as US pressurizes the Fund to give waivers to countries which fails on complying with conditions and on the domestic front governments in power use IMF conditions as a bait to change policy and ultimately gain leverage over opposition. In addition, several governments implement selected policy recommendations due to which an imbalance is created, and the burden of that imbalance is shifted on the poor. Considering all this, people talk of structural reforms and austerity that comes with an IMF program but at the core of all these, measuring compliance, has not been given much heed.

2.1.4 Methods of Measuring Compliance

It was after the East Asian Financial Crisis that the IMF properly started sharing some details of loan arrangements with member countries and gave academia a new course to follow. Researchers since have adopted new ways to test a program's viability but in general, two methods are used to study compliance. First, the aggregate measure of compliance, is based on a single factor (usually a proxy) or an index and has an advantage of ease and avoiding complications. However, adherents of the other measure, the disaggregate measures of compliance argue that the former approach may not be representative. In the latter method, instead of one proxy or index, compliance is studied in specific policy areas. However, there's always a challenge of controlling for other factors but before coming to that it's important to discuss the first method:

The most loved measure of aggregate method is the disbursement proxy. It is a measure where the percentage of loan disbursed by IMF (or drawn by a country) is used, and typically

more than 25% signals some form of compliance since after approval of the loan IMF disburse 25% of the amount and does the rest in tranches upon fulfillment of conditions. The benefit of this measure, which was first introduced by (Killick, 1995) is that a study can overcome the element of secrecy surrounding IMF arrangements. Also, the multidimensionality of the program is captured in an elementary way. But despite its simplicity there are a few drawbacks of this measure too as countries at times enter an IMF arrangement on precautionary basis, i.e. if they ever feel the need to draw out funds. This in no way can signal non-compliance but this drawback can be coped with as distinguishing such cases is evidently possible. But what cannot be are cases of exogenous shocks. It is when an economy faces exogenous shocks and are not able to comply with original terms of the arrangement, they still are disbursed funds by the IMF as they get a waiver. Moreover, even in some cases the loan arrangement is cancelled for a new one but cancellation does not always signal non-compliance and is also due to renegotiation. There is also an issue of phasing of disbursements or simply put, loans in early years is held and paid in later years of the program, indicating non-compliance. However, (Dreher A. , 2006) have found a solution to this problem by comparing actual disbursements to equal phasing, where any deviation would hint towards some form of non-compliance. This approach is quite representative but as indicated by several studies the role of powerful countries dilutes all this when they exert influence on IMF and other international agencies. Besides this (Vreeland, 2006) discusses how an index as an aggregate measure of compliance may not be a good idea as there are problems of assigning weights to the different components and when he compared different such measures and indices there was a low correlation. Moving on, the study lists and discusses the determinants of compliance which are very important to discuss but will be done so in the conceptual framework of this paper. But not to forget, the study mentions some cases of aggregate measures, (Nsouli, Antoian, & Mourmouras, 2004), (Dreher A. , 2006)

etc. revealing that compliance does not bid well with economic growth and hence for reforming IMF programs and for evaluating the program in general disaggregate measures of compliance be used. He argues that a policy condition of increasing interest rate may be easier than reforming the pension system and hence aggregate measures refrains from such distinctions and therefore, by controlling all others one major policy condition shall be studied at a time. In this regard he gave several examples and uncovered that the earlier studies on measuring compliance used disaggregated approach. Citing (Nooruddin & Simmons, 2006) Vreeland asserts that through disaggregate approach the study uncovered that in IMF programs a democracy and dictatorship are similar when it comes to expenditure on health and education. This is because dictatorships tend to spend less on these sectors, but democracies do so too when are in an IMF program (due to conditions of austerity). So, this approach to studying compliance has its benefits too just like the aggregate approach has its own.

Connecting the dots with our quest, it would be a great idea to study compliance through both the approaches. But the disaggregated approach has challenges attached primarily policy-specific data collection and the selection question addressing determinants of compliance. But considering all this, another factor, i.e. domestic political economy is an important factor to look forward to too.

2.1.5 Role of Politics & Economics in Measuring IMF Programs

(Joyce, 2006) found a new niche in IMF program implementation literature and contributed that a country's domestic political economy is the cardinal factor in program implementation. The Fund should push for using a country's political factors like special interest groups, ethnic fractionalization, quality of bureaucracy, political instability, political cohesion etc. in designing a program which will ensure better implementation. Moreover, this would also enable IMF's programs to be a better catalyst of private investment. This has also been

revealed by Nsouli et. al (2004) highlighting the nexus between institutions, program implementation and macroeconomic performance. They shed light on some interesting findings such as, improvement in quality of bureaucracy and law and order leads to decrease in inflation, a reduction in military involvement in politics before program starts leads to improvement of external current account, while decline in internal conflicts within a country leads to higher inflation. More such discoveries are reported in the study but a major takeaway for us is that their study suggested that the length of lags in the IMF's adjustment and stabilization program could be a topic of future study; hence, we're considering all such suggestions in refining our gap.

Continuing the discussion, non-compliance though is a major but not the only factor which hinders these adjustments programs. Placing the blame entirely on the recipient countries would be unfair and IMF too shares the blame of failures of these programs. In this regard, Easterly (2005) critically analyzes structural adjustment lending, right from when they were first introduced by World Bank's former President Robert McNamara. He argues that both the Fund and Bank are of the opinion that these adjustment programs fail due to non-compliance but if such is the situation why do these institutions time and again bail out these countries, knowing that the programs will have a bad fate? An argument in this regard is often cited that adjustment is a multi-stage process and requires more than one program. The researcher puts it in medical analogy words that if a patient is readmitted to a hospital after a treatment this signifies that the first treatment was not result-bearing. The statistics in this study reveal startling revelations, mentioning that countries though with repeated loans found no relief in their macroeconomic conditions and countries like Pakistan stood with much poorer nations like Niger and Ghana (all three spent 61% of the time from 1980-99 in IMF programs). The process in Pakistan's case did not stop here and a new loan was given to every new regime in power post 2000 and the trend continues. The author in his paper adds

that since these countries were short of international reserves, donors and other lenders closed doors on them and encouraged IMF and the Bank to keep them involved to give a “good housekeeping seal of approval”. This finding has been revealed by Independent Evaluation Office (IEO) of the IMF 2002 report. However, the primary question remains: though repeated lending, partly due to external pressures has been a norm but how effective are these loans? In the sample of Easterly (2005) a trend can be seen in this regard that one hand countries like Uganda had positive growth trends but with a high black-market premium and inflation throughout the period. Pakistan too was no different and had the highest growth rate in the sample. However with a high fiscal deficit which led to piles of debt accumulated at the end of adjustment loan period. Looking at the statistics with 2.7% per capita growth rate and -3.3% terms of trade growth percentage why Pakistan felt the need of more dollars when the millennium 2000 started? Added to this, the Bank and Fund themselves admitted failure of their programs when such countries including Pakistan was added to the list of HIPC (Heavily Indebted Poor Countries), which were then eligible to some relief.

The takeaway from this paper is that looking at the trend of how IMF lends to countries, prolonged use of IMF credit did not deprive any country from immediate future use of Fund resources. In this regard, IMF is of the view that adjustment is a slow, multistage process but the question is how efficiently were the Fund resources utilized? Did the Fund change its approach after giving repeated loans? In the sample countries of Easterly (2005) countries with high growth ended up with a high inflation and black-market premium, along with the negative terms of trade. Also, it is important to note that giving the HIPC status to borrowers is a clear-cut admission that IMF’s remedy did not work and is an admission of failure. In short, the paper reveals that there are mixed policy changes associated with adjustment lending, but a positive growth effect induced by the policy changes is missing. It is also

pertinent to mention that in light of all the discussion the author asserts that IMF adjustment also fails because of influence of the G7 countries.

Now moving on to more recent instances from literature, (Arpac, Bird, & Mandilaras, 2008) place their energies towards assessing the extent to which IMF programs are implemented in a sample of 95 countries, covering the period 1992-2004. The gap identified in the literature is that they used the most up to date economic and political factors that influence implementation of a fund program. Moreover, they shed light on the three factors that are used as proxies of implementation, namely the disbursement rate, irreversible interruption and the implementation index and after a correlation analysis and through assessing pros and cons of all three (with reference to past literature) used interruption index for their quest. Henceforth, the study discusses that special interest group in a country have considerable influence on program implementation however, there poses a great challenge in using a workable proxy for it which's upheld by empirics. Therefore, for assessing any IMF program it is important to first ascertain the extent to which it is implemented and for ascertaining that extent it is compulsory to determine the factors that influence it. Their results indicate several policy recommendations and state: initial economic conditions do not influence implementation; trade openness, however, does and in open economies fund programs have greater chances of implementation. Nonetheless, as economists say that there is always another side of every event in economics and it is that open economies are prone to external shocks. But the shocks can be favorable or otherwise and where, on one hand, a positive shock may lead to non-implementation (as balance of payment may improve), on the other, a negative shock leads to more demand for IMF loans and hence the need for better implementation. In addition, IMF's financial assistance, power of veto players and domestic politics too influences implementation. However, as we discussed earlier, citing, Easterly (2005), we will assert again that implementation is in many cases plagued by powerful

countries. This is ingenuously discussed by Dreher, Vreeland, & Sturm (2015) too, asserting that politically important countries are lucky enough to get less stringent conditions. They studied 314 programs of 101 countries spanning from 1992-2008 and revealed that in their sample a program on average gets eight conditions and UNSC temporary members get 2.5 less conditions than otherwise. In other words, these countries get about 30% less conditions. The also cited Zimbabwe's example when in 1991-92 Zimbabwe was entering into an IMF program and UNSC at the time was deciding the fate of Iraq as it had invaded Kuwait. Resultantly, Zimbabwe was pressurized to vote along with the United States, in the resolutions UNSC was slapping on Iraq, else more IMF conditions would be levied on them. Such instances hint towards the debate and strengthen it that world powers influence IMF lending.

But despite of all this, literature stresses that adjustment programs, be it in Latin or Europe are no different than each other at its core. (Hermann, 2017) in this regard quotes Brazilian President when the latter visited Spain amid financial crisis in 2012. He reports her saying that the model of austerity which was previously called adjustment had bankrupted Latin America in 1980s and no good can come from it if there are no incentives for growth and investment. (Hermann, 2017) in his article compares adjustment programs in Europe and Latin America and argues that the panacea used in Latin decades ago was also used for Europe after the breakout of 2008 crisis. Ironically, this very mechanism of neoliberal deregulation is what had partly caused the crisis in the first place. The programs in both the regions were aimed at altering employment and social systems had differences too; and where in Latin the financial sector was made flexible, in Europe, on the other hand, the public sector took cautious steps to bring it under her control. (Takagi, 2016) also addressed these market differences and similarities. He analyzed Asian Programs after the breakup of Asian Financial Crisis with the bailout to European countries after the 2008 Global Financial Crisis.

The crux of his study is that the difference between European and Asian programs is not in content but philosophy. European programs are more transparent, have realistic assumptions, there's more collaboration among stakeholders and the primary of all, there's more emphasis on ownership.

It is important to add that during the Global Financial Crisis of 2009 IMF did tried to modernize conditionality by introducing ex-ante conditionality. IMF (2009) reveals that the IMF board adopted review-based conditionality as opposed to structural performance criteria earlier. This decision was taken to increase national ownership of Fund programs but ascertaining if the desired objects have been achieved is yet to be explored.

2.2 Conceptual Framework

Studying IMF programs without specifically studying target areas is meaningless. Dreher (2006) builds a strong connection in this regard; he argues that IMF programs in a panel of 98 countries have a negative effect on growth. However, compliance with conditionality reduces this negative growth effect but does not mitigate it entirely. But this isn't the entire equation as several other factors, economic and political, play a keen role in the connection between IMF programs, conditionalities and growth. In this regard literature has suggested several variables: As per Dreher (2004) compliance depends positively on per capita GDP but negatively on short-term debt and government consumption. Similarly, Aprac, Bird and Mandilaras (2008) asserts that in open economies IMF programs are better implemented but the economy then is also prone to external shocks. So, the net effect varies from case to case, as positive shocks in an economy can lead to non-implementation of a program as the country could no longer need the feel for Fund's resources. The paper also reveals that the number of conditions may rise if a country is a past borrower, but (Dreher, Vreeland, & Sturm, 2015) says that on average a program has eight conditions but if a country is a temporary member of UNSC, it gets 2.5 less conditions than otherwise. Hence both politics and economics influence these lending conditions and the country which is the highest contributor to the Fund's monies have a greater say. Therefore, it is often discussed, even among academic circles, that countries enjoying good relations with the United States get favorable conditions. The instance of Zimbabwe quoted in the literature review from an academic article is a classic example of this belief.

Moving on, Nsouli et. al (2004) highlights the nexus between institutions, program implementation and macroeconomic performance. This paper says that a decrease in military's involvement in politics before the start of a program improves current account deficit while a more efficient bureaucracy and decline in internal conflicts decrease inflation.

Inflation is a cardinal factor in program implementation as IMF mandates a borrower to slash social spending to improve fiscal balance. This leads to inflation and to curb that the condition of increasing interest rates is set, and this condition not only affects investment in a country but affects economic growth too.

They shed light on some interesting findings such as, improvement in quality of bureaucracy and law and order leads to decrease in inflation and a reduction in military involvement in politics before program starts leads to improvement in external current account. These links are epically captured in Vreeland (2006) too which highlights that programs implementation is significantly affected by regime type. The literature in general stresses that programs are better implemented in a democracy, but this author also adds that due to IMF programs the distinction between democratic and autocratic regimes is minimal when it comes to health and education spending. Similar connections between fund programs and reserve to debt ratio, presence of foreign reserves problem, domestic bank credit to GDP ratio, and reserves to debt and debt service to GDP ratio have been upheld by (Bird & Rowlands, 2017).

2.2.1 Gap Analysis

Now coming to the proposed gap, the study analyzes the effect of IMF programs on Pakistan's economy with the latest data available. Usually Fund programs are assessed in a panel study but my motive is to study it in a time series context. Obviously, these programs cannot be efficiently studied without using the most effective mode of measuring conditionality, so my energies are diverted to that too. However, a proxy for conditionality may not be significant in a time series model. Therefore, if need be the study will further explore the topic by studying macroeconomic variables at the start and end of every program in the sample. We will also reveal if the program was completed or had partial implementation

As earlier said Pakistan's economy is like an old school bus and as the bus driver speeds up the bus, his engine heats up. In the same manner since the past 19 years or so whenever we achieve a high growth rate, we end up in a fiscal deficit which translates into a twin deficit. Therefore, my motive is to give a policy recommendation from the assessment in the literature and empirics as how can we do differently? How can we lead on a path of growth without facing the situation of twin deficit that leads us to the door of IMF, every now and then? Should we look forward to capital controls as even IMF had allowed that to European countries after the 2008 Crisis? Should we reconsider our other policies? What should we do? This is a question left which will be addressed at the end of the study but before that a before-and after analysis, followed by a case study approach of every program from 1988 till date will be covered.

2.3 Before-and-after Analysis

For this section the study intends to use data which is used in the econometric analysis. To better analyze the trends in data we use descriptive statistics. Also we have divided tenures into pre 1990s (military regime), 1990s (PPP-PMLN's democratic regimes), 1999-2007 (military regime) and 2008-2017 (democratic regime), thus dividing regimes as per military and democratic regimes.

Growth rate of per capita GDP

Per capita GDP's growth rate in our studied period (1988-2017) is averaged at 1.98% and went as high as 5.44% while came at a negative -1.44% when it was at its lowest ebb. Since 1980 PC GDP grew at 3.6% while the year which we have marked as our sample start date (1987) PC GDP rose at 3.1% and in 2017 (end date) it was growing at 3.6%. Apparently, the statistic looks shiny if we look at it in absolute terms. Now looking at it regime wise it grew at an average of 1.8% in the democratic regimes of 1990s, followed by 2.06% in the decade when a military dictator was in power and finally declined back to 1.6% in the decade from 2008 to 2017-18. It seems that military dictators have contributed greatly to PC GDP when compared to democratic regimes, however, Zaidi (2014) asserts 1999-2007 regime as "gains without sustainability" and where 1980's military government regime enjoyed US military and financial support due to Afghan Jihad, the military ruler post 1999 found the same in post 9/11 situation.

Investment

Investment in our studied period rose as high as 20.8% to a 14% low on the other end. Now if we look at it regime wise, in 90s the mean was 19.09% as opposed to a decade earlier when it was 18.5%. However, then in 2000's military regime investment dropped back to 17.46%, up till 2017 when it came down to 15.8%. Here we have discovered two surprising facts. One,

that in military dictators' tenure though growth is high, investment growth rate has decreased. Two, that in the much-termed lost decade of 1990s investment rate increased than it was in both military regimes of 80's and new millennium's.

Government Consumption

Moreover, Government consumption over the studied period is averaged at 11.2% with rising as high as 16.7% and decreasing to a minimum 7.78%. Coming to regime wise, the average in 1980s was 11.5%, followed by 13.2% in 1990s while 8.9% and 10.5% in military and democratic regimes post 1999, respectively. Now this measure swings both ways like a pendulum. The definition of general government final expenditure on World Bank's website reveals it consists of all current expenditure by the government excluding defense. Hence, we see a rising trend from 80s till end of 90s and then decreasing again until a democratic government increases it again. This can signify that the governments in 90s were inefficient as ideally a government should decrease its current expenditure and increase development. But since we do not have data of development expenditure for now (since it's out of our covered variables), we can look at another side too. A high current expenditure can also mean that a government is employing more people and hence paying more salaries. No doubt why governments of 1990s were called employment factories. The military government of 1999 onwards, however, did the opposite by privatizing state owned enterprises.

Inflation

Now coming to a favorite variable of many, inflation in the sample was averaged at 8.35% with a minimum and maximum value of 2.5% and 20.2%, respectively. Regime wise, in military ruler of 80's the rate was averaged at 7.4% but rose to 9.1% in the democratic era of 90's. It was surprisingly at 5.5% afterwards till 2007 but shot to 9.29% after 2007 till 2017. In this democratic tenure time frame if we take out 2008 which had more than 20% rate the

average drops to 8.1%. Analyzing the trend in regime type wise, it is pertinent to note that inflations tends to be lower in military dictators' time. Support from the data above in per capita growth suggests that military leaders had shiny averages in their tenures but as soon as their governments ended inflation skyrocketed. Two instances are pertinent to note here, that is, in 1988 when a democratic government came inflation rose from 4.6 to 8.8%. Also, in 2007 when again the scenario arose inflation jumped from 7.5 to 20.3%. Digging deeper we know realize what Zaidi (2014) meant by "gains without sustainability"

Terms of trade

Terms of trade has a mean of 8.2%, and a minimum and maximum values of 277 and -100 for the given sample period. It increased by 10.39% in 1990s, decreased by -22.2% in 1999-07 dictator's rule and by -25.9% afterwards. Hence we can see that the need for IMF loans and creating an import led growth started from 1999 onwards. Every government afterwards merely added to the mess. Further breaking it down in the years after 2007 we see that the growth rate was positive in PPP's tenure while negative in PML-N's tenure.

Also if we look at a sister variable for more discussion here, we see that in military dictator of 80's tenure average foreign reserves were of 2.5 months, while in the 90s it decreased to 1.59 months and increased again in military's 8 years' rule post 1999 to 4.7 months, followed by 3.56 months in PPP's and to almost 4 months in PMLN's (up till 2017).

Therefore, we see that from 1999 onwards though reserves in months have increased but terms of trade have worsened leading to a situation where IMF had to intervene. This situation needs to be addressed by Pakistan's policy makers because if exports aren't competitive enough to pay for imports this spell of IMF bailouts will not stop. Even if the country place curbs on imports, there will be repercussions and globalization isn't already on our side either. Any quotas or embargoes on imports of any trading partner will surely not go

unpunished. Moving ahead, before-and-after analysis of economic variables won't depict a true picture of our economy and society alone.

Chapter 3

Data and methodology

This study is based on finding the effect of IMF loans on economic growth in Pakistan. For that, following Dreher (2006) we adopt the same methodology and estimate effect of IMF loans on growth. We will start by finding the determinants of IMF loans and IMF programs. Both loans and programs are separately studied because loans capture the effect of how IMF influences a country through money disbursed while IMF programs capture the effect of how IMF influences a country through its advice. Next we will find what determines IMF conditionalities and will finally move towards estimating the effects of loans on growth. The first three equations are estimated to aid our final equation, as suggested by Dreher (2006).

1. Determinant of IMF loans and programs:

$$Y_{1n,t} = \alpha X_{1n,t} + \beta X_{2n,t} + \varepsilon$$

where Y1 represents IMF loans disbursed as a percentage of GDP (or IMF programs in case of determinants of IMF programs), X1n is the list of economic variables affecting IMF loans and X2n is the list of social and political variables affecting IMF loans while α and β are the estimators of these variables and ε is the error term.

Y1 stand for IMF loans and IMF programs, thereby we estimate two equations:

- (a). The equation when Y1 is IMF loans, the explanatory variable X1 consists of short-term loans and current account deficit (both expressed as a percentage of GDP). Whereas, X2 stands for special interest groups. The data sources and their definitions are given in appendix
- (b). However, when Y1 is IMF programs, the explanatory variable X1 consists of total debt service and government consumption while X2 is simply the dummy variable for democracy,

2. Compliance with IMF conditionality:

$$Y2_t = \alpha X3_{n,t} + \beta X4_{n,t} + \varepsilon$$

where Y2 represents the dummy variable representing compliance with conditionality. It is 1 where at maximum if 25% of the amount in a year under equal phasing remains undrawn and 0 otherwise. X3n is the list of economic variables affecting IMF loans and X4n is the list of social and political variables affecting IMF loans while α and β are the estimators of these variables and ε is the error term. All the economic and social variables with their definitions and data sources are given in the appendix.

3. Effect of IMF on economic growth:

$$Y3_t = \alpha X5_{n,t} + \beta X6_{n,t} + \mu Y1_t + \pi Y2_t + \varepsilon$$

where Y3 represents effect of IMF loans on economic growth. Here X5n is the list of economic variables affecting IMF loans and X6n is the list of social and political variables affecting IMF loans while α and β are the estimators of these variables and ε is the error term. Moreover, Y1 and Y2 have already been introduced and have μ and π as estimators.

Here Y3 is per capita GDP while X5 is a list of variables consisting of inflation, investment and terms of trade. Whereas, X6 consists of fertility rate, globalization index, school enrolment and life expectancy. For details we have to refer to the appendix.

Moreover, the study is a time-series, covering data from 1987 to 2017. We have started from 1987 because prior to that there was a big gap in IMF loans and data constraints led us to choose this year as the starting period. Moreover, we ended up with the year 2017 because in that year an IMF program was completed; a new program started in 2020 which is still in progress. Moving ahead, mostly studies on IMF have used panel data but that's because of

data availability constraints. However, in Pakistan's case every now and then different IMF programs were carried out and now with 30 years' data, it is best to capture the effect of these programs.

As discussed earlier too we will estimate the effect of IMF programs and loans on growth in Pakistan. For that the dependent variable is GDP per capita as suggested by (Dreher A. , 2006). Dreher used 5 years averages due to data constraints but we are good to go with yearly data. Besides this log of GDP per capita at the beginning of each period, lagged values of government consumption and investment as a percentage of GDP, inflation rate, growth rate of terms of trade, life expectancy, fertility rate, and school enrollment rate have all been taken from World Bank's data repository. Whereas, for IMF variables, IMF loans as a percentage of GDP is used. Besides this, for the variable of compliance with conditionality (Dreher A. , 2006) is consulted again. The variable is a proxy for implementation and is 1 where at large 25% of the committed amount under equal phasing remains undrawn and 0 otherwise. Also the variable for IMF programs is a dummy which is 1 when there was an IMF program in the country and 0 otherwise. Moreover, since Pakistan sought IMF loans every time due to current account deficit problems and not due to currency or some other crisis, I make no distinction in any program and include Stand-By, Extended Fund Facility and all other programs, including concessionary ones.

The literature on our topic also suggested several variables such as the rate of monetary expansion, the overall budget deficit, real GDP growth, the share of foreign short-term debt in total foreign debt, international reserves (in months of imports), the total level of outstanding debt, current account balance as a percentage of GDP, total debt service (% of GDP), openness to trade, LIBOR on 3 months' credit to US banks etc. These variables are included in our general model and then dropped if were insignificant until we arrived at our final model. The literature, as discussed in the review also mentions variables like degree of

democracy, proportional representation, a dummy for special interest groups along with many other political and social variables but are included if significant.

Literature has revealed that OLS may not be a good option for studying Fund programs. There may be a problem of endogeneity. Dreher (2006) started with OLS but then moved on to seemingly unrelated regressions (SUR). However, this task will be finalized upon estimations in the next chapter but we plan on comparing OLS and SUR and will make a decision. Dreher (2006) mentions that results of SUR are more efficient and consistent so if that's the case in our results too we will stick with SUR.

Moreover, apart from regression analysis the study conducts a data analysis. We read data related to the program and conducted a before-and-after each program analysis. Also we adopted a case study approach where important components and/or results of each program are specifically highlighted. The motive of this task is to mitigate the negative impact which may have occurred due to the use of our model and data. Also reading the data directly, on one hand, and assessing every program separately on another, captures the motive of this study in an elementary way.

3.1 End of chapter Appendix

Variable	Definition	Data Source
Per capita GDP	Annual growth rate of GDP per capita in LCU where per capita GDP stands for total GDP divided by total population.	World Bank (2019)
IMF Programs	Dummy=1 if an IMF program is active in a specific year and 0 otherwise	IMF annual reports, various years
IMF Loans (as a % of GDP)	Total purchases from IMF on the general resource account in a specific year	World Bank (2019)
Disbursement rate	Share of IMF loans agreed and actually drawn until program expiration. Dummy=1 and represents compliance if more than 25% is drawn until program expiration.	Dreher (2003), Dreher (2006) and IMF (2019)
Short-term debt (% of total debt)	Short-term debt refers to debt with maturity of less than one year. Also includes interest cost in arrears on long term loans	World Bank (2019)
Total debt service (percentage of GNI)	Consists of total debt repaid, principal plus interest cost	World Bank (2019)
Democracy	Dummy equals 1 if there was a democratic government and 0 if autocratic	Idea taken from Marshall and Jaggers (2000). Used this dummy due to data constraints in source

Government special interest	Dummy equals one when at least one government party is special interest	Beck et. al (2001)
Inflation	A consistent and persistent increase in the general level of prices	World Bank (2019)
School Enrolment	Gross enrollment ratio is the ratio of total enrollment, regardless of age, to the population of the age group that officially corresponds to the level of education shown. Secondary education completes the provision of basic education that began at the primary level, and aims at laying the foundations for lifelong learning and human development, by offering more subject- or skill-oriented instruction using more specialized teachers.	World Bank (2019)
Log (life expectancy)	Life expectancy at birth indicates the number of years a newborn infant would live if prevailing patterns of mortality at the time of its birth were to stay the same throughout its life.	World Bank (2019)
Log (fertility rate)	Total fertility rate represents the number of children that would be born to a woman if she were to live to the end of her childbearing years and bear children in accordance with age-	World Bank (2019)

	specific fertility rates of the specified year.	
Government consumption (% of GDP)	All current expenditure incurred by the government including compensation	World Bank (2019)
Index of Globalization	Based on 23 variables that relate to different dimensions of globalization	Dreher (2006b)

Chapter 4

Outlook: Pakistan and IMF – Analysis from a different perspective

4.1 Foreword

The story of Pakistan's engagement with IMF cannot be summed in mere econometric analysis perspective. There are various impediments involved, due to which researchers historically have preferred studying IMF programs in a panel setting. However, this study aims to move a step ahead and employ different methodologies so as to reduce the problems induced by lack of a better data and model. We henceforth, aim to employ a before-and-after analysis and a case study approach. But before that it is important to recapitulate the state we are in. Over the past three decades we have spent 70% of our time in IMF programs or at least 21 years in the past 3 decades. This is summarized in the table below (taking idea from Bird (2001), along with completion rate of programs:

Table 4.1.

Facility	Date of Arrangement	Expiration Date	Amount Agreed	Amount Drawn	Completion Rate
Extended Fund Facility	Sep 04, 2013	Sep 30, 2016	4,393,000	4,320,000	98.34%
Standby Arrangement	Nov 24, 2008	Sep 30, 2011	7,235,900	4,936,035	68.22%
Extended Credit Facility	Dec 06, 2001	Dec 05, 2004	1,033,700	861,420	83.33%
Standby Arrangement	Nov 29, 2000	Sep 30, 2001	465,000	465,000	100.00%
Extended Credit Facility	Oct 20, 1997	Oct 19,	682,380	265,370	38.89%

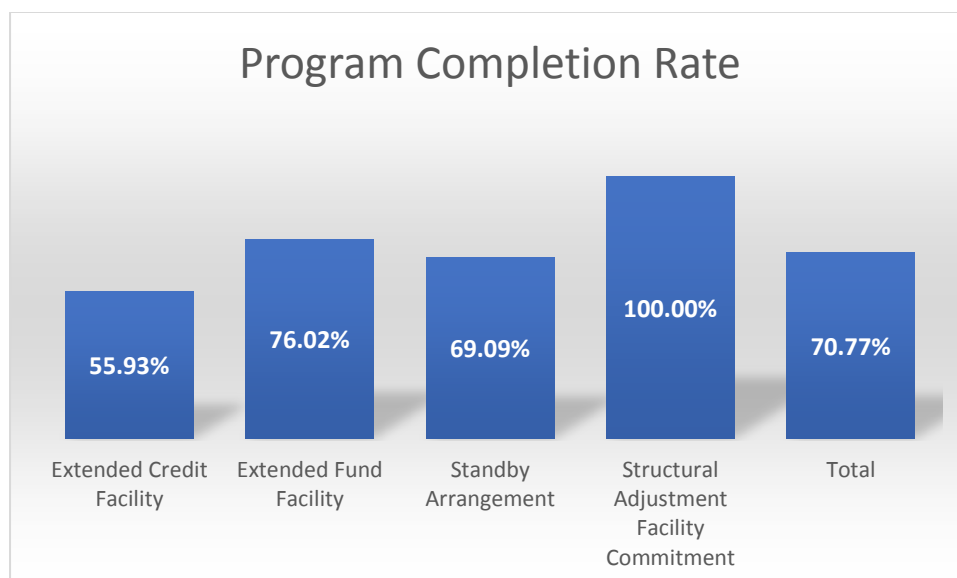
		2000			
Extended Fund Facility	Oct 20, 1997	Oct 19, 2000	454,920	113,740	25.00%
Standby Arrangement	Dec 13, 1995	Sep 30, 1997	562,590	294,690	52.38%
Extended Credit Facility	Feb 22, 1994	Dec 13, 1995	606,600	172,200	28.39%
Extended Fund Facility	Feb 22, 1994	Dec 04, 1995	379,100	123,200	32.50%
Standby Arrangement	Sep 16, 1993	Feb 22, 1994	265,400	88,000	33.16%
Structural Adjustment Facility Commitment	Dec 28, 1988	Dec 27, 1991	382,410	382,410	100.00%
Standby Arrangement	Dec 28, 1988	Nov 30, 1990	273,150	194,480	71.20%
Extended Fund Facility	Dec 02, 1981	Nov 23, 1983	919,000	730,000	79.43%
Extended Fund Facility	Nov 24, 1980	Dec 01, 1981	1,268,000	349,000	27.52%
Standby Arrangement	Mar 09, 1977	Mar 08, 1978	80,000	80,000	100.00%
Standby Arrangement	Nov 11, 1974	Nov 10, 1975	75,000	75,000	100.00%
Standby Arrangement	Aug 11, 1973	Aug 10, 1974	75,000	75,000	100.00%
Standby Arrangement	May 18, 1972	May 17, 1973	100,000	84,000	84.00%

Standby Arrangement	Oct 17, 1968	Oct 16, 1969	75,000	75,000	100.00%
Standby Arrangement	Mar 16, 1965	Mar 15, 1966	37,500	37,500	100.00%
Standby Arrangement	Dec 08, 1958	Sep 22, 1959	25,000	0	0.00%
Total			19,388,650	13,722,045	70.77%

Source: IMF, 2020 and Author's own calculations

The table reveals that since our first program in 1958 we have had a completion rate in total of 70.77% but if the programs from 1988 till date are studied we see a completion rate of 73% which is quite impressive and can signal a great deal of compliance with IMF conditionalities. However, if from the SAF program of 1988 to 1997 we read the data we find that the completion rate falls to 43.19%. That's quite a stark decrease!

Another trend in the data which we can see is that reaching out to the IMF became more like a norm after 1988 and the results aren't promising either. We discuss that in before-and after analysis but it's important to look at program types with completion rates:



Prima facie it seems that our completion rate of SAF is 100% but that's because we have had only one SAF programs while many Standby arrangements. The data is as follows:

Table 4.2

Facility	Completion Rate	No of Programs
Extended Credit Facility	55.93%	3
Extended Fund Facility	76.02%	5
Standby Arrangement	69.09%	12
Structural Adjustment Facility Commitment	100.00%	1
Total	70.77%	21

Source: Author's own calculations from IMF's raw data.

4.2 Case Study Approach

Referring to Siddiqui, Shoaib, Bilal and Khan (2019), IMF Monitor (2020)'s article scanner and their dataset by Kentikelenis, Stubbs and King (2016) this study adopts a case study approach of each of the IMF programs since 1988. As mentioned earlier the topic in a time series constraint has several impediments of data quality. Hence to neutralize the impediment to the extent possible we start off a case study with program of 1988.

4.2.1 Standby Arrangement/Structural Adjustment Facility 1988-1991

Twenty-six days after PPP came in power, Pakistan entered into a 3 years SAF program along with a 2 years Standby Arrangement. During that time Pakistan's foreign exchange reserves were fast depleting with only about 1.5 months of reserves left, overall budget deficit stood at 6.2% while broad money growth, inflation and current account deficit stood at 7%, 3% and 8% than a year earlier value of 16%, 1.6% and 4.6% respectively. The classic features of these paired programs were to liberalize exchange rate and trade, increase investment and stabilize the economy in general.

The initial results were a success but as the 90s decade is marked by constant spells of political instability, the effect translated to economy too. The liberalization programs were greatly hampered too. Added to the miseries, the unrest in Gulf States led to an increase in oil prices on one hand, and decreasing remittances on another (Siddiqui 2019). Due to these reasons as Din (2008) puts it, the program was prematurely terminated in December 1990 in which per capita GDP took a further downturn from 4.3 to 1.46 and so did other factors; inflation increased, investment decreased and terms of trade further went into negative.

4.2.2 Standby Arrangement 1993-1994

Din (2008) reveals that the political instability caused by ousting government of PML-N, along with the tragic floods in 1992, the macroeconomic fundamentals were in shambles. The caretaker government exercised an effort to do something about it, took some pre-program steps and entered into a Standby Arrangement which was renounced only 7 months later to be replaced by another program

4.2.3 Extended Fund Facility/ Extended Credit Facility of 1994-1995

A twin program scheme was initiated again to structurally adjust the economy on internal and external front. The objectives were more or less the same as were in 1988. However, in the following year (1995) the program was suspended on the pre-text of non-compliance of conditionalities. Shafqat (1996) argues that with India building up its nuclear arsenal PPP's PM too, despite opposition from IMF and pressure from people to increase welfare spending, took care of military's arsenal buildup. Resultantly things came at a cross where her populist manifesto, need for working on nuclear arsenal made it hard to comply with Fund's conditions and the program was cancelled. Hence, due to these reasons primarily the program ended.

4.2.4 Standby Arrangement 1995-1997, followed by Extended Fund Facility/Extended Credit Facility 1997-2000

Din (2008) argues that after suspension of the previous program of PPP government the state of economic affairs was fast worsening. Resultantly, first an SBA followed by a EFF in 1997 was adopted. The programs had objectives of increasing revenue, adopting a contractionary monetary and fiscal policy, reforming CBR (now FBR) state owned enterprises, adopting a fully market based exchange rate gradually and lowering customs and adopting other such initiatives to boost investor confidence.

The program was somewhat smooth and in 1997 the SBA was changed into EFF and inflation at least had impressive results as it came from 12% in 1995 to 6% in 1998. GDP per capita growth too was increasing year-on-year till 1996 but then things took a downturn again. With Pakistan's nuclear tests in 1998 and the sanctions following it, within months the program was cancelled. Things were sour for the country, even after the military takeover in 1999 until 9/11 happened and Pakistan became blue-eyed boy of the Western powers again.

4.2.5 Standby Arrangement 2000-2001

Din (2008) reports that after coming to power the military ruler post 1999 had several economic woes, coupled with the miseries brought by sanctions of 1998 nuclear tests. Pakistan had no choice but to reach out to the IMF again. However, the IMF, considering Pakistan's history with the Fund was very rigid and instead gave a 10 months Standby Arrangement program. It had 56 conditions attached which was unprecedented as normally such has a program has about 19 conditions which aren't too stringent. Failing on debt repayments and import bill, Pakistan had no choice but to complete the program and it was first program to be completed after 1977. Moreover, being the sole decision maker the General found it rather easy to implement the program. Although Pakistan faced a severe drought in this time but the General managed affairs. Further the privatization of UBL, PTCL and divesting Sui Southern Gas Company's shares proved as a cash cow. This led to a

buildup of trust between IMF and Pakistan, and Pakistan was awarded with another program in 2001.

4.2.6 Extended Credit Facility 2001-2004

In December 2001 Pakistan entered into a new program with 71 conditions, relating to SOE reforms, economic management in general, liberalization of trade and improving tax mechanism etc. along with performance criteria and structural benchmarks. This program too had successful areas just like the previous one and the Banking sector was restructured along with reforms in the tax machinery. However, investment, inflation and terms of trade did not have much success. In 1999 the General led the country with 1.24% of per capita GDP which after twists and turns was at -0.23 in 2001 and 1.04 in 2002. Things, however, took a different turn when Pakistan sided with US in War on Terror and at the end of this program in 2004 GDP per capita growth rate had reached to 5.1%. However, investment continued to decline under this military ruler's regime be it with or without an IMF program. Inflation too after a slight decline increased from about 4% in 1999 to 7.4% by the end of this program in 2004. Also due to decrease in spending fiscal deficit was in check and due to aid and support from Western allies the external front bade well too, till the bubble busted afterwards

4.2.7 Standby Arrangement 2008-2011

Although the General smoothly ran his government after 9/11, but things turned upside down at the end of his tenure. Current account deficit loomed, growth which was based on import led consumption (Economic Survey, Various Years) started to show signs of despair. Added to the adversities, Pakistan had to face a stringent security situation, investor confidence shrank and the economy was in shambles.

Although this program was called off on account of non-compliance but it did achieve something. Considering the international oil price increase, Global recession, massive floods in 2010 and the suicide bombing and other security issues, under this program Pakistan

started off with -0.35% growth rate in per capita GDP and ended with 0.6% only to be increased further by a 100 basis points the next year. Moreover, inflation too dropped from 20 to about 11.9% while terms of trade faced a deep dive from 2.7 to 0.1%.

4.2.8 Extended Fund Facility 2013-2016

PML-N's tenure was a time in which the economy started to stand back on its feet. Much of the security problems had been neutralized during the previous regimes. The war against insurgents in the country was eliminated to a great extent but was not over. Fortunately, oil prices decreased and the contracts on Gwadar Port in the previous regime had materialized to become China Pakistan Economic Corridor. However, the government still had a lot of economic woes, combined with an acute energy crisis. Investor confidence lost during the operations against insurgents had to be restored. Rightly IMF (2013) asserts that to the problems just mentioned international and local investment attraction was pertinent for long run success. Hence with a structural adjustment program a ray of hope emerged. During this program until the end of it in late 2016 a lot of macroeconomic goals were met and several governance and restructuring schemes found success.

However, it was after this program and towards the end of 2017 when a political crisis started to reverse back everything. Was it this government's policies or the political turmoil is a question beyond the scope of this paper but surely at the end of government's tenure things were similar to what was found at the end of every government since 1988.

With this the pertinent question remains, is it IMF, our country's internal situation or a mix of both that is hampering growth in the country? This study focuses mainly on IMF and we found that IMF's policies aren't any favorable either. But like it is always said the solution always lies within. What could it be? Capital Controls? A national consensus on economic affairs? A mix of different such strategies? We will give our policy implication in our

conclusion but let it be an area to be explored in depth in the future. However, with this we move on to our econometric analysis next.

Chapter 5

Estimation and Results

This section starts off by analyzing the models in the previous section. First, an equation tests the determinants of IMF programs, followed by determinants of IMF loans. Next we assess what determines compliance with conditionality followed by the core objective of this study, the effect of IMF loans, programs and compliance with conditionality on economic growth in Pakistan.

We had initially planned to use OLS but just like Dreher (2006) we moved on to Seemingly Unrelated Regressions (SUR). Although both the methods had similar results but the estimator is more efficient and consistent as opposed to OLS.

5.1 IMF Programs in effect

Table 5.1 Determinants of IMF Programs

IMF Programs in effect	
Total Debt Service (percentage of GNI)	0.1788 (0.000)
Democracy	0.5457 (0.000)
Current account deficit	0.0485 (0.032)
Short-term loans	- 0.04617 (0.004)
Number of observations	31
R ²	0.4208
Prob(F-Statistic)	0.0000

N.B. Each result has a coefficient followed by p-value in parenthesis

Table 1 shows results of one of the IMF variables. As shown above, four variables are reportedly significant and interestingly this is in line with results of Dreher (2006) except that in that study current account deficit was insignificant, as opposed to the case otherwise here.

We started off with a general to specific approach. Initially we placed the above four variables, along with Special Interest Group, Libor and general government final consumption expenditure (% of GDP) in our regression. Then we dropped each variable one by one, by order of their level of insignificance until we arrived at these results.

The results signify that IMF programs are likely to be in place when Pakistan's government has a high total debt service. Various issues of Pakistan's Economic Survey reveals that most of Pakistan's programs with IMF had been between late 1980's till 2020 and that's the time frame when total debt service kept on increasing. Moreover, the result of IMF programs being active in a democratic country are somewhat different than literature. Dreher (2006) and Vreeland (2003) etc. asserts that IMF programs are usually active in non-democratic regimes. However, in our study we reveal that IMF programs are mostly in place when a democratic regime is in place. Zaidi (2005)'s Issues in Pakistan Economy hints towards this. It explains that in non-democratic regimes the military dictators were helped by powerful countries financially for geostrategic and geopolitical reasons, hence the dependence on IMF programs was not much. Moreover, with the help of these powerful states, military rulers in Pakistan successfully deferred loans to a future date, which were matured after a change of regime. Hence after change of regimes types in Pakistan, i.e. after 1987 and after 2007, the need for IMF programs was strongly felt, which spanned over many tenures. With being mostly under IMF programs these democratic regimes had little say in making independent policy or implementing their manifestos. If they did exert their say, the programs deviated from core objectives and were cancelled, just as Shafqat (1996) mentions the fate of twin programs of 1994-95.

Now coming towards current account deficit (CAD) it is understandable that CAD and IMF programs have a positive relationship. The need for repeated programs also arose that ever since 1999 Pakistan's growth rate in terms of trade is becoming negative (with the exception of 2008-13's regime). Interestingly, short term debt bids negatively with IMF programs. This is in line with Dreher's study and the reason given is that short-term debt reduces IMF's supply and hence the negative association.

In short, IMF programs have a positive association with CAD, debt-servicing, democracy and negative with short-term loans because of the reasons discussed here and in the previous chapter.

5.2 IMF Loans

Table 5.2 Determinants of IMF Loans

IMF Loans (in percent of GDP)	
Democracy	0.014 (0.000)
Current account deficit (% of GDP)	0.0016 (0.001)
Short-term loans (% of GDP)	-0.009 (0.004)
Number of observations	31
R2	0.406
Prob (F-Statistic)	0.000

Referring to Dreher (2006) again, the Fund influences economic growth through advice, conditionality, money disbursed and moral hazard. Moral hazard can be captured through if a program is in place in a country or not, and has already been discussed above but the money component is estimated in table 2. Here too we started with a general to specific approach

and dropped LIBOR, Special Interest Group, general government final consumption expenditure, and total debt service.

According to results IMF loans are more likely to be disbursed when short term loans are low, current account deficit is high and a democratic regime is in place. As witnessed in Table 1's results the demand for IMF programs increases with a higher total debt service, similarly as Dreher and Vaubel (2004) argues that higher short term debts decreases IMF's supply. Linking this to IMF loans now, IMF loans are probably given when short term debts in the country are low. The government before reaching out to IMF undertakes some prior actions to get favorable conditions. Keeping this in mind it slashes subsidies and raise utilities prices even before reaching to IMF, or even increase taxes. Governments, like in Pakistan, undertakes measures to create a breathing fiscal space by trying to defer debts apart from the taxes and subsidies etc. mentioned above. These measures leads to our finding that short term debts are likely to be low when IMF loans are disbursed.

Moving on, the finding that a high current deficit at times of IMF loans in place is no surprise as a government reaches out to IMF due to depleting foreign reserves. Since the start of 2000 millennium however, a new notion has emerged. Every successive government tries to gain growth by increasing spending, the spending translates into fiscal deficit which also due to imports translate into a situation of twin deficits. Thus, the need for IMF arises, and with adjustment and stabilization which benefit the incumbent government in power, the can is thrown down the road to a successive government. A new government comes and the process repeats and it has been repeating till date.

Lastly, the reason given for interpretation in IMF programs' case applies here too when the variable democratic regime is considered. Military regimes in Pakistan sustained due to help from Western powers for their support. In democratic regime's case the situation is a bit

different and hence as opposed to theory, higher IMF loans were given in democratic regimes.

5.3 Compliance with Conditionality

Table 5.3

Compliance With Conditionality	
Broad Money	0.0072 (0.534)
Inflation	-0.156 (0.508)
Democracy	-0.119 (0.561)
Number of observations	31
R2	0.064
Probability (F-statistic)	0.582

As has been revealed in literature and in our study finding a true variable for compliance is a tedious task. The most loved measure of compliance is the disbursement proxy. It is a measure where the percentage of loan disbursed by IMF (or drawn by a country) is used, and typically more than 25% signals some form of compliance since after approval of the loan IMF disburse 25% of the amount and does the rest in tranches upon fulfillment of conditions. The benefit of this measure, which was first introduced by (Killick, 1995) is that a study can overcome the element of secrecy surrounding IMF arrangements. Also, the multidimensionality of the program is captured in an elementary way. But despite its simplicity there are a few drawbacks of this measure too as countries at times enter an IMF arrangement on precautionary basis, i.e. if they ever feel the need to draw out funds. This in no way can signal non-compliance but this drawback can be coped with as distinguishing such cases is evidently possible. But what cannot be are cases of exogenous shocks. It is when an economy faces exogenous shocks and are not able to comply with original terms of the arrangement, they still are disbursed funds by the IMF as they get a waiver. Moreover, even in some cases the loan arrangement is cancelled for a new one but cancellation does not always signal non-compliance and is also due to

renegotiation. There is also an issue of phasing of disbursements or simply put, loans in early years is held and paid in later years of the program, indicating non-compliance. However, (Dreher A. , 2006) have found a solution to this problem by comparing actual disbursements to equal phasing, where any deviation would hint towards some form of non-compliance. We used the refined proxy suggested by Dreher but our results were still insignificant as revealed in Table 3 above. Hence we moved on to the next and final research objective.

5.4 Effect of IMF Loans, Programs and Compliance with Conditionality on Growth

Table 5.4 Effect of IMF on economic growth

Per Capita GDP	
IMF Loans (in percent of GDP)	-71.4484 (0.0220)
	0.2483
Inflation	(0.0660)
	-0.5374
Investment	(0.0792)
	-1.3261
Terms of trade	(0.0294)
	-61.547
Fertility rate	(0.0051)
	-0.3991
Globalization Index	(0.0846)
	-318.895
Life expectancy	(0.0106)
	6.9868
School enrolment	(0.0793)
Number of observations	31
R ₂	0.52914
Prob(F-Statistic)	0.017069

Finally, coming to the subject estimations of this study, the effect of growth per capita is assessed in times of IMF programs. A general to specific approach was adopted and variables insignificant at 10% level were dropped. Hence the variable for compliance, IMF Programs and general government consumption were insignificant and hence dropped.

As opposed to our base study Dreher (2006) IMF loans and not IMF program's variable is significant. At a 5% significance level, it is revealed that with every \$1 increase in IMF loans GDP per capita decreases by \$71.4. Also globalization, fertility rate, investment, life expectancy and terms of trade has a negative association while school enrollment and inflation has a positive effect. The relationship of school enrollment can be explained as a better educated nation leads to better decisions and hence growth whereas, in case of inflation, a high per capita GDP warrants more disposable income and that's only possible in case of low inflation. The life expectancy's negative sign is evident in Pakistan's case as people over 60 are no longer a part of productive population and hence do not contribute to national income. So growths rate rise with low life expectancy. This is also because Pakistan is a country suffering from high malnutrition and stunting and a low life expectancy, unfortunately, ensures less people to feed. In addition, growth rate is high when fertility rate is low because of the reason just discussed and primarily because of the element of population in calculating growth per capita. This trend in life expectancy, fertility and other such social factors can change if health facilities and stunting in Pakistan improves.

Moving on to terms of trade and although surprising but per capita GDP increases with a negative terms of trade. This is very classic of Pakistan since growth in Pakistan is not only based on consumption but Pakistanis prefer imported to local products. Hence, this pattern has led to negative terms of trade which results in the need for reaching out to IMF. Since 1960s various efforts has been made to introduce import substitution industrialization policy but over the years due to non-ease of doing business, stringent tax policies, inadequacy and now high power tariffs have discouraged high quality of local products. This also explains why the lagged variable of investment has a negative coefficient. Last but not the least, globalization usually promotes growth but in our case the

association is negative. This warrants that our policy makers revisit our policies and look into why our international trade and other aspects of globalization is doing us harm than good.

Chapter 6

Conclusion

The study is aimed at finding the impact of IMF loans, programs and compliance with IMF conditionality on economic growth in Pakistan. We started off by finding the determinants of IMF programs and found total debt service, democracy, current account deficit and short-term loans to be the significant determinants. Next we moved on to determinants of IMF loans and democracy, current account deficit and short-term loans made up to the list. Surprisingly there was coherence in the list, as opposed to literature. Moreover, we also found out that in the case of Pakistan democracy is a strong determinant of IMF loans and programs. This is opposed to the literature at large, as usually dictatorial regimes found its place here. Moreover, when we moved on to our test for compliance with conditionality our variable was found to be insignificant. We leave this as a quest to be followed in future research work where a better variable is dug out or conditionalities are studied in a disaggregated approach method.

However, our results of effect of IMF growth on per capita GDP were very significant. As hinted by literature the effect of IMF loans on economic growth is negative. In Dreher (2006)'s case the effect was mitigated by compliance with conditionality while in our case the variable for compliance was negative so this cannot be summed and as we said, we leave this point to be assessed in future course of work. Besides this the variable for inflation and school enrolment were found to have a positive relationship with growth while investment, terms of trade, fertility rate, life expectancy and globalization index had a negative association. The reasons for these are already discussed but the crux of this study is that IMF loans have a negative relationship on growth and these loans are mostly given in democratic regimes. Are democratic regimes to be blamed for the piles of debt accumulated and the

heavy dependence on IMF? With this the pertinent question remains, is it IMF, our country's internal situation or a mix of both that is hampering growth in the country? Moreover, in our case study approach we found that promises made in election manifestos, opposition from parties not in government, populist sentiments, global and natural factors like oil price shocks, global recessions, floods, security issues and changing global geostrategic environment and influence from powerful countries play a vital role in program success too. At large the study focused mainly on IMF and we found that IMF's policies aren't any favorable either. But like it is always said the solution always lies within. What could it be? Capital Controls? A national consensus on economic affairs? This is an arena to be assessed in future studies but our policy makers seriously need to give heed to the fact that something novel and different needs to be done now. The oft-repeated going to IMF is like going again and again to the same doctor whose remedy did not work previously.

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