EXTENDED FUND FACILITY: INTERNATIONAL RELATION

NEWS: IMF loan to Pakistan: why the latest tranche was passed

WHAT'S IN THE NEWS?

The IMF disbursed $1 billion to Pakistan under its Extended Fund Facility to support structural reforms amid economic distress, while India abstained from the decision citing past misuse and national security concerns.

Context:

- The International Monetary Fund (IMF) has approved a disbursement of $1 billion (approximately ₹8,500 crore) to Pakistan under its Extended Fund Facility (EFF).
- This disbursal comes amid Pakistan's worsening economic crisis and strategic scrutiny from India.

What is the Extended Fund Facility (EFF)?

- The EFF is a loan-based support mechanism of the IMF.
- It is meant for countries with medium-term balance of payments issues, especially due to structural weaknesses in their economies.
- Unlike short-term financial bailouts, the EFF:
    - Has longer repayment periods.
    - Supports gradual and long-term economic reforms.
    - Targets issues like chronic deficits, weak governance, and low public investment.
- EFF loans:
    - Must be repaid with interest.
    - Are linked to policy conditionalities such as fiscal consolidation, tax reform, and banking sector improvements.

What is the Resilience and Sustainability Facility (RSF)?

- The RSF provides affordable, long-term financing to support:
    - Low-income and vulnerable middle-income countries.

    - Countries at risk due to climate change or pandemics.
- Objective:
    - Support macro-critical reforms to enhance economic resilience.
    - Reduce balance of payments risks by improving sustainability and readiness.
    - Provide buffer capacity through better institutions and emergency response tools.

Why Did the IMF Extend EFF Support to Pakistan?

1. Economic Deterioration:

- GDP stagnation: Pakistan's GDP in 2023 was $338 billion, lower than its GDP in 2017.
- Persistent inflation: Five consecutive years of double-digit inflation, peaking at 23.4% in 2024.
- Debt dependency: Pakistan has taken 28 IMF loans in 35 years.
    - Also borrows from China, UAE, Saudi Arabia, Paris Club, and Islamic Development Bank.

2. Structural Weaknesses:

- Low domestic savings and investment.
- Poor infrastructure and financial governance.
- Limited female labour force participation.
- Frequent fiscal slippages and mismanagement.

3. Recent Signs of Progress:

- Inflation sharply dropped to 0.3% in April 2025.
- Foreign exchange reserves have increased.
- Key structural reforms:
    - Introduction of Agricultural Income Tax.
    - Improved fiscal transparency and spending controls.

India's Dissent and Concerns:

1. Misuse of Previous Loans:

- India raised concerns over Pakistan's track record of failing to implement reforms despite multiple IMF loans.
- Allegations of misuse or diversion of IMF funds in the past.

2. National Security Risk:

- India cited concerns that funds could be diverted for military or terror-linked activities, particularly due to Pakistan's alleged support for cross-border terrorism.

3. Diplomatic Action:

- While countries cannot vote against IMF decisions, India abstained as a form of diplomatic protest.

About the International Monetary Fund (IMF):

1. Introduction:

- A specialised UN agency, created at the Bretton Woods Conference in 1944.
- Headquartered in Washington D.C., USA.
- Objective: Ensure global monetary stability post-WWII and Great Depression.

2. Core Objectives:

- Promote international monetary cooperation.
- Maintain exchange rate stability.
- Facilitate balanced growth of global trade.
- Assist in reducing poverty and supporting stable economic development.

3. Major Functions:

- Economic Surveillance: Monitors macroeconomic trends, offers policy advice.
- Financial Assistance: Provides loans to countries with balance of payments problems.

- Technical Assistance & Capacity Building: Helps governments in budgeting, tax policy, data systems, monetary operations, etc.
- Conditional Lending: Disbursal is tied to structural reforms and fiscal discipline.

4. Membership and Voting:

- 190 member countries.
- Each country contributes a quota (in SDRs) based on:
    - Economic size
    - GDP
    - Trade openness
- Voting Power Formula:
    - 1 vote per 100,000 SDRs contributed + basic votes
    - U.S. holds the highest voting share

5. SDRs (Special Drawing Rights):

- Not a currency, but an international reserve asset.
- Can be exchanged for freely usable currencies (USD, EUR, GBP, JPY, CNY).
- Acts as a liquidity buffer for member nations.

6. Organisational Structure:

- Board of Governors: Apex body; usually finance ministers or central bank governors of member countries.
- Executive Board: 24 members representing the entire membership, responsible for day-to-day operations and loan decisions.

Conclusion:

- The IMF's disbursal to Pakistan under EFF reflects its role in addressing global financial stability, even in politically sensitive regions.
- While Pakistan's structural reforms show early signs of improvement, India's strategic concerns over security and accountability highlight the complex interplay between economic support and geopolitics.

- The IMF's conditionality mechanism and surveillance will be key to ensuring that the loan serves its intended economic reform objectives.

Source: https://indianexpress.com/article/explained/explained-economics/imf-loan-to-pakistan-why-passed-9995800/