

## **Painful Economic Decisions Await New Government**

*by Khaleeq Kiani, The News*

Excerpt: " Those who have followed the country's economic policy closely believe that for nearly the past two years, decisions were led by ad hocism and political pressure rather than prudent economics. Many within the government, who rose and benefited by taking the side of former prime minister Shaukat Aziz, now concede that major decisions were delayed too long. The more one delays, the more one's vulnerability to painful corrective steps. So don't be surprised if in the near future, the government's chief economic spokesperson, Dr Ashfaq Hasan Khan, directs scathing criticism at the former prime minister..... Sources within the PPP said that the party chairperson, Benazir Bhutto, had an over three-hour long detailed presentation and question-answer session with former World Bank official Abid Hassan, prior to her return from self-imposed exile a few weeks ago. It remains to be seen whether the economic tips given by a development banker can synchronise with the "Roti, kapra aur makaan" slogan."

## Painful economic decisions await new government

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ISLAMABAD: As the countdown begins for the general election, independent economists, bureaucrats and the intelligentsia have started to worry whether the next civilian administration – regardless of which of the major political parties it is led by – truly grasps the enormity of the economic shocks that await it.

Notwithstanding the economic turnaround claimed by the present government, there is grave concern about whether the major political parties have enough innovative ideas and the human resource required to tackle the coming challenges.

A record current account deficit, stagnant exports, an increasing fiscal deficit, social indicators that are still amongst the worst in Asia, an energy shortage and rising inflation with artificially-controlled prices are just a few of the challenges faced by Pakistan's economy.

Most of these problems are the result of earlier policies that only served to generate increased troubles – despite some short-term whitewashing of the issues – rather than offer fundamental solutions or remedies from delayed corrective measures. Should a political party be prepared to take difficult and unpopular decisions right at the very beginning when voter expectations are high? Can it even afford to take such decisions? Or is a democratically-elected political government destined to failure by design?

They say that economics is more of an art than a science, and faulty twists and turns could lead to anything except a masterpiece. This is perhaps what happened to the Pakistan economy, the growth of which was based on consumption led by a credit-card mindset rather than the fundamental economic principles of growth through saving, expansion and production.

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Amongst the economists, there is unanimous agreement that the sustainability of the current account deficit in the long run is one of the very real concerns for Pakistan's economy. In the short-term, a current account deficit in excess of \$11 billion may not pose a problem as long as foreign inflows are available for financing.

In the long-term, however, merely the cost of financing this deficit is going to present enormous challenges. The cost has been increased further by the fact that most of the sectors that attracted direct foreign investment (DFI) in the recent past are those that yield returns in domestic currency rather than in export earnings. Telecommunications, tobacco, banking and oil & gas are just a few examples.

Major sources of foreign inflows, such as DFI and workers' remittances, are going to stay in the near future. In fact, they are expected to grow on the back of anti-American sentiment among the rich investors of Muslim countries and the improving living standards of expatriate Pakistanis. However, the cost of a continued DFI flow will soon become a question once foreign investors repatriate their profits, dividends and loan repayments.

Almost every economist concedes that the minimum profit margin cannot be less than 20 per cent for any foreign investment. Therefore, if the DFI jumps from \$1 billion a year to \$8 billion, the cost of return will go up proportionately. Similarly, foreign investment in stocks in a market such as ours could be as good for the economy as bad: it can come in like a hurricane but also go the same way, leaving deep wounds in its wake.

A case in point is East Asia.

In the recent past, Pakistan could have attained structural strength in the shape of exports since the country sided with major powers. However, expectations have not been met in this regard. Rising at a negligible three or four per cent a year, Pakistan's exports have trailed far behind its imports.

In this area, in fact, Pakistan's performance has been different from that of other high-growth developing countries. The Philippines, for example, achieved growth through expanding its export-oriented manufacturing sector, as compared to Pakistan where the agriculture-led export base has remained more or less constant over the past eight years.

There may have been some problems with the manufacturing sector as well, whose growth has fallen short of targets over the past few years. However, perhaps the decisive impact came from the fact that the Pakistani currency did not keep pace with depreciations in competing economies.

Most economists agree that the rupee is overvalued, but differ on the point of whether the devaluation should be five or 15 per cent, or somewhere in between. Not without reason had the entire western world been insisting, for 15 years, that China appreciate its exchange rate. If Beijing resisted that pressure, its undervalued exchange rate helped its exports capture markets across the globe.

Economists also agree that an increase in utility prices, particularly those of oil, gas and electricity, is inevitable because of flawed policies and delayed decisions in the past few years. There is no doubt that balance-sheet problems are as serious today as they were in the 1990s, since these prices were kept low artificially for more than a year. This has led to the build-up of a fiscal gap of Rs180 billion, leading to a resurfacing of the chronic inter-corporate debt problem.

This will not only lead the fiscal deficit beyond six per cent of the GDP (as opposed to the four per cent target), it will also expose the state-owned corporate sector to default. This, in turn, will result in a vicious cycle of economic mismanagement or a slide down the soft available target development programme.

Over the past eight years, inflation has always remained an uncontrollable problem – mainly because of hoarding and the manipulation of essential commodities such as

wheat, sugar and vegetables by individuals within the government. However, the government's faulty policies in terms of the pricing of oil, and the fact that hydropower developers were discouraged, were the real factors necessitating the far costlier thermal power and the required increase in energy rates. The government thought that by capping energy prices, it would be able to contain inflation. But it turned out that the delay would cause even higher inflation, as predicted by the State Bank.

**LITTLE TO CHOOSE:** Can such decisions be taken by a newly-elected government? And, was the situation created with the intention to ensure the coming government's failure? There is little difference between the election manifestoes of the PPP and the PML-Q as far as economic policy and the well-being of the people are concerned.

The PML-Q boasts of its success and is contesting elections with the slogan of policy continuation. Meanwhile, all of part II and to some extent, part III of the PPP manifesto (which deal with the economy and the social sector) appear to be more or less the same as what we used to hear from Mr Shaukat Aziz. These include the portions related to debt policy, inflation, the strategic stocks of commodities, the taxation system, the private sector and the health and education sectors.

Perhaps an even more interesting factor is that of the economic teams of both these prospective parties. The PML-Q does not have any prominent economist who could run its economic policy, and in case the party again comes to power, it may have to continue to bank on borrowed technocrats.

The situation is no different for the PPP, where populism dominates the posture. A repetition of a programme, eg as the Social Action Programme, may not be welcome in the current circumstances. People such as Shah Mahmood Qureshi and Shanazir Wazir Ali may offer the policy depth required in the agriculture and social sector respectively. However, it is hard to identify at the moment an overall economic leader who could translate these sectoral inputs into a broader economic policy.

The exception may be Naveed Qamar, whose experience lies only in privatisation. The PPP will also face tough development competition in Punjab. It will have to perform better than the now-blacklisted Shahbaz Sharif and Pervez Elahi, who initiated improvements in the health and education sectors.

Sources within the PPP said that the party chairperson, Benazir Bhutto, had an over three-hour long detailed presentation and question-answer session with former World Bank official Abid Hassan, prior to her return from self-imposed exile a few weeks ago. It remains to be seen whether the economic tips given by a development banker can synchronise with the "Roti, kapra aur makaan" slogan.

Interestingly enough, the political parties that do have a pool of economic managers have no chance of coming to power in the Jan 8 elections. The PML-N, for example, has at its disposal the services of veteran Sartaj Aziz, an experienced Ishaq Dar and a fresh Ahsan Iqbal, all of whom have practical experience in public policy.

The Jamaat-i-Islami has the veteran Professor Khurshid Ahmed and development economist Dr Zubair.

Perhaps this is when people start to believe in conspiracy theories.