**LONG TERM ECONOMIC DIRECTION**

**AND**

**CONSISTENCY OF ECONOMIC POLICIES[[1]](#footnote-1)**

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China, India and Brazil are three emerging countries in different parts of the globe with differences in culture, history and politics but have done extremely well in terms of economic development in the recent years. Pakistan on the other hand with similar culture, institutions and history as India but different political evolution has not done so well on a comparable basis.

Pakistan and India have shared the same history, culture and politics for many centuries. Politicians in both these countries behave in not too different ways and are known for their penchant for self aggrandizement and their own interest maximization. The only notable difference is that since independence India has evolved into a stable democratic state with smooth transition of power through elections held at regular intervals while Pakistan has had a turbulent political history with the military in power for almost half of the time. Institutional framework for Governance inherited from a common British colonial legacy have not changed much in its structure in the two countries. Economic policies pursued by both the countries are also broadly comparable although there are several nuanced differences due to the path dependence built since independence. As a matter of fact Pakistan had followed relatively more market friendly and less of the statist economic policies compared to India. All comparative studies have shown that Pakistan’s economic performance had been impressive until the late 1980s while India was stuck with the Hindu Rate of Growth. Both countries, for different reasons, embarked upon a broadly similar if not completely identical reform path in 1991.

The question that needs to be explored is: “Having pursued almost identical policy reforms in content over almost two decades why are the outcomes so different in Pakistan?” I would submit that political instability, lack of continuity and consistency in economic policies, abrupt reversals and frequent turns and absence of a consensus on long term economic direction are the factors that distinguish Pakistan from India, China and Brazil.

China, India and Brazil have enjoyed political stability with orderly and predictable transitions of power at regular intervals. China through the changes in the Communist Party Leadership every five years and India and Brazil through electoral process at fixed intervals have built in mechanisms of smooth political transition. Pakistan, on the other hand, had six different elected and interim governments in the decade of 1990s, military rule between 1999-2002, an elected but military dominated regime between 2002-2007, a Caretaker Government followed by an elected Government since 2008. The frequent interventions and disruptions in the electoral process had unintended adverse consequences for the economy.

The credibility in respect of continuity and consistency of policy reforms in India was tested in late 1990s at the time of the exit of the Congress Party and entry of the BJP Government. The fact that the BJP Government did not overthrow or disrupt the reforms of the previous Government in any significant way was the turning point for the Indian economic policies. The implied bipartisan political support for economic reforms convinced the businesses and investors that the ‘licence raj’ was a history and the ground rules and the enabling environment have undergone a fundamental shift. Since then the investors have not looked back despite many unfortunate incidents such as abandonment of Tata Motors in West Bengal, the pressure on POSCO in Jharkand, the land dispossession and title disputes and mining rights issues of various kinds. The fact that the Congress led Alliance in 2004 persisted on the same path and moved in the same direction despite resistance by the Communist Party has further enhanced the sustainability of these reforms.

In Pakistan, Prime Minister Nawaz Sharif initiated serious and bold reforms by embarking upon a series of fundamental policy changes in foreign exchange and trade regimes, privatization of state owned corporations and banks. These reforms had a positive impact for the first two years but confidence was slow in returning and the Sharif Government was dismissed in the meanwhile. Benazir Bhutto who came to power in 1993 did not reverse the reforms but did not show the same vigor and commitment as she wanted to distance herself from the Nawaz Government. The rivalry between the two parties was so fierce that the new Government was constantly engaged in battles of political survival. The economy was once again relegated to back seat and economic management was weak and uneven. The reforms initiated by the previous government that were still in their infancy did not receive the kind of nurturing and attention that they deserved. Policies were not overthrown but major projects such as the Motorway were cancelled giving mixed and confused signals to the investors and businesses who became doubtful about the sanctity of the past contracts. Nawaz Sharif Government, upon return to power, put all independent Power Projects (IPPs) initiated during the previous Government on hold giving a wrong signal to investors. Pakistan’s economic achievements under the Musharraf period pursuing the same policies with greater resolve and determination were impressive. Growth rate averaged 7 percent per annum, poverty incidence fell from 33 percent to less than 20 percent, unemployment rate declined significantly, debt ratios tumbled and foreign inflows were higher than those to India as a proportion of GDP. Pakistan was able to float 10 and 30 year sovereign bonds in world financial markets at fine pricing with huge oversubscription. But this situation did not last long.

The transition from the military-cum-civilian government to a democratically elected government again created similar problems. The new government, instead of consolidating on the gains of the previous policies and programs and correcting the course where mistakes were made, interrupted or reversed some of the good initiatives taken by the Musharraf regime. The political uncertainty and instability once again put the reforms at risk and before the benefits started accruing to the population the policies, programs and projects initiated by the previous government were put on the back burner. The new government has not done even one large transaction of privatization in last three years while the recurring losses of inefficient public enterprises and utilities are fueling the growing fiscal deficit and crowding out expenditures on education, health, social safety nets, etc. Funding for Higher Education Commission was curtailed and the Overseas Scholarship Program was suspended causing a severe set back to Faculty Development in our Universities. Local Government System which had devolved administrative and financial powers to Districts, Tehsils and Union Councils was abruptly abolished in 2008 denying the people the opportunity to get their problems and services delivered at grass root level.

According to Wilder “The short tenure of governments has helped create an environment where the incentives are to focus on short-term political (and financial) gain rather than on achieving mid-to-longer-term policy objective.” The absence of credible long term commitment to reform by the major political parties was therefore a point of departure.

The contrast between China and Pakistan in implementing economic policy reforms also makes an interesting case study. Both the countries have been under authoritarian or non democratic rule - China uninterruptedly and Pakistan for three decades out of its six decades of history. If it is true that the authoritarian regimes are in a much better position to undertake economic reforms then the question arises why hasn’t Pakistan ---governed by authoritarian rulers for half of its life-- not been able to make a headway? China has become one of the power houses of world economy and is likely to emerge as the largest single economy by 2020. For a country with the majority of population living in chronic poverty, misery, starvation and absence of decent living conditions to transform itself into a global economic power during a short period of four to five decades is unprecedented in the human history. Pakistan, which was ahead of China and most East Asian countries in most economic indicators in the 1960s is now facing a fierce struggle against terrorism, religious extremism and fundamentalism. What happened in the two countries that has produced such contrasting outcomes despite the fact that Pakistan has followed similar economic policies as China.. Reliance on Private Sector and foreign investment, openness to the world economy, integration with the financial markets were pursued by both the countries albeit with different intensity, speed and nuances. The distinguishing feature between the two countries was that the collective leadership in China allowed policy reforms to proceed cautiously, with assured continuity and predictability about the long term direction set by Deng Xiao Ping in 1980. Party leadership changed at regular intervals of time just like the transitions in democracies but did not make any difference as the ownership of the reforms was broad based, widely shared and the polices were themselves developed after debate and discourse within the party cadres and the national Peoples’ Congress. These policy reforms therefore survived every single regime change in China since 1980. In contrast, the military leaders who came to power in Pakistan practically ran a one man show where the personal whims, caprices and prejudices of the individual drove the decision making process. Institutions of governance were weakened, dissent and difference of opinion were curbed, checks and balances were removed and a coterie of sycophants and time servers surrounded the military leader. “In the short term military governments are less constrained by political considerations and the need to build consensus around reforms. The record is less clear in the longer term as military governments are pressured into accommodating a broader spectrum of political interests and responding to domestic and international pressures to legitimize and democratize their governments.” Whatever sound policies and reforms were introduced under each of the three military regimes in Pakistan were soon reversed, halted, interrupted or abandoned by their elected successors. This lack of continuity and consistency has cost Pakistan a huge price. The decades of 1960s, 1980s, 2000, were characterized by above average rates of economic growth but were followed by serious economic crisis, macro-economic instability, stagnation in growth rates and an overall sense of drift. The democratically elected leaders who replaced the military rulers were not prepared to be seen as pursuing the policies of the military dictators although they may have no substantive difference with those policies.

Investment in social development takes a long time, perseverance, commitment and dogged resolve to bear fruits. Each incoming government found that the projects initiated by their predecessors were deficient, had to be scrapped or redesigned and launched again. By the time some modest gains begin to loom at the surface the regime is overthrown or replaced and the whole exercise begins afresh. No wonder, the social indicators of Pakistan are so weak and the unemployment among the youth drove them in hordes to become captive of the militant forces against whom the Pakistan army is now engaged in a deadly battle.

Brazil, a country associated with hyperinflation, poverty, stark income inequalities has also undergone a dramatic transformation. President Cardoso, a Social Democrat who came to power in 1994 carried out economic policy reforms such as privatization, reduction in trade barriers and fiscal prudence that set Brazil’s economy in the right direction. There was almost a collapse when Lula, the leftist leader of the workers’ Party was elected the President. But he vowed not to tramper the free market reforms he inherited and also continued with the same policies but also introduced an effective program of social transfer to the poor in form of Bolsa Familia. Today Brazil is one of the leading nations among the emerging economies with low inflation, high foreign investment, declining poverty and lowering income inequalities.

The success stories of China, India and Brazil provide some insights that can be contrasted with the case of Pakistan. In each of these cases the credibility of economic policy and movement along the set long direction assured the investors, businesses and the rest of the world that there was widespread bipartisan political support for the reforms and broad economic policy direction with minimal risk of reversal. The political will, commitment and support for the changes was not always apparent but the actions spoke louder than words. In Pakistan, a country with public pronouncements all in favor of the policy reforms, the actual results has been disappointing. Weak and unstable democratically elected governments failed in implementation because they were too much preoccupied with the struggle for their political survival. The military governments did a better job in implementation but because they lacked legitimacy their deeds and actions were reversed by their successors causing uncertainty and reinforcing lack of credibility.

Assuming that a political consensus is to be established what should be the main elements of a long term economic agenda for Pakistan that will help put the country on the path of sustained and equitable development? In the following section an attempt is made to spell out the elements of such an agenda. The need for such a consensus among all the political parties arises because a number of tough economic decisions would have negative and unpopular repercussions in the short term but positive outcomes in the long term. As each ruling party wishes to win the elections it is not willing to take decisions which provide ammunition to its opponents. But it is in the interest of the opposition party that once it assumes power it should inherit a healthy economy. Therefore it is in the mutual interest of both the ruling as well as opposition parties to combine their hands and take the bitter pill. Such an action will reduce the uncertainty and put the economy on the right path.

**Long-Term Economic Agenda**

First, there is a need for reprioritization of our on-going medium term public sector spending at all levels - the Federal, Provincial and State owned corporation - and elimination of low priority, low impact development projects, waste and inefficiencies. A clear link between public expenditure and the desired economic outcomes – incomes, output, prices and employment – should guide screening of the projects, programs and policies for inclusion in the priority list. Only targeted subsidies and conditional cash transfers that can reach the poor segments of the society should be provided for and the current across-the-board subsidies available to everyone should be discontinued. The combination of subsidies being received by the well to do and their tendency to evade taxes is an explosive bomb for the public finances of the country.

Second, domestic savings rate is dismal and has made us heavily dependent on foreign assistance. Saving rate has to be stepped up by providing incentives for households, corporate, small businesses and overseas workers through National Saving Schemes, Mutual Funds, Bank Liability Products, Insurance, etc. Public sector as a whole has been a source of large dis-savings mainly because of losses of public corporations, low resource mobilization arising from exemptions, evasion, waivers, weak compliance, and indifferent enforcement. Empirical studies have shown that at the current tax rates, the tax collection can be raised by 4-5 percentage of GDP while the plugging of the leakages, waste and corruption in public corporations and development projects can provide an additional fiscal space of 2-3 percentage of GDP. An action plan should be implemented by the Finance Managers to capture these missing public savings.

Third, privatization program has been stalled for quite some time now and the loss making public corporations are bleeding the exchequer. Not only that privatization is necessary for the health of public finances it will also contribute to efficient allocation of resources, improvement in productivity, expansion of output and employment. The vested interests have so far prevailed upon the decision makers by perpetuating myths and falsehoods about privatization. Calculations by independent experts show that if the Steel Mill was privatized in 2007 the losses of almost Rs 100 billion incurred since then would have been avoided. It is time to ignore all the noise by the vested groups made in the name of national interest and proceed with the privatization in an open and transparent manner both by off-loading limited shares of profit making companies and disposing of the loss making corporations. To avoid cronyism and fronting pre-qualification of the bidders against specified criteria and careful screening process must be incorporated in the law. As soon as a decision is taken to privatize the entity its control should be taken out of the hands of the Administrative Ministry and transferred to either the Ministry of Finance or Privatization Commission. The consistent efforts to subvert the privatization process by the administrative ministries will thus be contained.

Fourth, the government by becoming too intrusive is now an impediment in the way of new enterprises, start-up companies and small businesses in the private sector. Entrepreneurship is discouraged by excessive rules and regulations. Too many agencies and departments are involved – often at cross purposes – in cumbersome and long drawn process of clearances, no-objection certificates, building permits, land acquisition, provision of utilities and infrastructure. A single building project requires more than two dozen government agencies and departments with connections and corruption as the main determinants. Land acquisition, taking possession, transfer of title deed and registration of urban property have proved a nightmare to the prospective investors. City Governments and District Governments should develop simplified IT-enabled procedures and post the land titles with ownership details on the website. Public utilities should be provided in bulk at dedicated Industrial estates in each urban centre. Computerization of land records – urban and rural – has been lingering on for almost a decade because of the resistance offered by the present functionaries. An independent authority should be given legal powers to carry out this task. Successful examples such as Sunder Industrial Estates should be replicated all over the country.

Fifth, decision making at the government level is convoluted and complex because of the overlap, duplication and multiplicity of organizations, elongated hierarchal chain within the organization and a growing tendency for turf protection and inter-agency rivalry. Rules and procedures along with structural changes in the ministries / attached departments have to be drastically modified and powers delegated and accountability established to make room for fast track decision making. The financial rules have outlived their utility. These must be reviewed and the redundant rules purged out and the latest rules that are in force placed together in form of a manual that is freely accessible on the website. The enormous discretionary power enjoyed by poorly paid, ill trained low level functionaries such as Patwari and SHO have alienated an ordinary citizen from the Government and should be transferred in the hands of higher caliber Civil Servants. Only qualified and younger officers should be entrusted these functions.

Sixth, the gap between the capacity of the government to deliver public goods and services and the growing expectations of the public at large is getting wider. This can be filled in by an empowered and well functioning local government system. The Local Government System 2001 had rightly devolved powers, authority and resources for basic public service delivery to the Union Councils and District Governments. This system, with some required changes, should be reinstated as soon as possible with the Provincial Governments responsible for policies, standards, assuring quality and monitoring results. Police Order 2002 with built in checks and balances of Executive Magistracy should form the Citizen-Police relations. The logical follow up of the 18th amendment and the National Finance Commission Award by building up strong representative Local Government System. For the last two years the entire LG System has been put in abeyance as the old system was abolished and no alternative system was put in its place. The void and vacuum at the district level due to the absence of a well functioning Local Government system created a large number of avoidable problems. We should learn lessons from this regrettable experience. The previous system of devolving powers, authority and resources for 12 Provincial Departments should be restored with some changes and modifications. Law and order, Disaster Management and Revenue Record Maintenance should be transferred from elected Nazim to a neutral and impartial government official. Executive Magistracy needs to be re-established for supervising the Police and keeping it accountable. Police order of 2002 should be stripped of all the subsequent amendments and the Police commissions revived and strengthened. Urbanization is placing many severe strains and urban management for large metropolitan cities done on modern lines.

Seventh, investment decisions in Energy, rehabilitation of irrigation system, education and health should be made on a medium term basis. Pakistan’s reservoirs and dams have only 30 days storage capacity. Hydro power is the cheapest and cleanest source of energy. But dams – large or small – could not be built because of political differences among the provinces. It is imperative that all the provinces reach a consensus and then allow the construction. As changes in the government bring about abrupt reversals private investors desiring to invest in long gestation projects suffer from a high degree of uncertainty. They are also hesitant to invest or participate in any public-private partnership because they are not sure as to what will happen to their project when the new government comes to power. To minimize this uncertainty the Parliament should discuss and approve the projects and approve allocations for the entire five year plan period which should remain unchanged at the time of annual budget except for fine tuning. This will assure that some essential activities that produce results in the medium to long term are not sacrificed at the altar of short term expediency and arbitrary cuts in development projects.

Eighth, the assertion of an independent judiciary in Pakistan in the last few years is a most welcome step. But the priority of the judiciary should be to make dispensation of justice easily available to an ordinary citizen without him incurring huge unaffordable costs or committing years of productive life in inordinate delays, adjournments, stay-orders and multiple appeals. Expeditious disposal of cases pending at all tiers of courts and integrity of lower judiciary can unlock a large dead or illiquid capital for investment. The Federal Board of Revenue cannot recover as much as Rs.100 billion of taxes owed as the cases are pending in the courts for years altogether due to cumbersome procedures, delaying tactics adopted by the lawyers and no penalty for filing frivolous litigation. The commercial banks have billions of loans stuck up as the borrowers have either obtained stay orders from the courts and thereafter the cases are adjourned for one reason or the other or the decrees granted by the courts have not been executed. Others get encouraged by such tactics and they also pursue the same path. Most of the litigation in Pakistani court system arises from the disputes on land, residential or commercial property. A large number of projects are either delayed or abandoned as the potential investors find themselves entrapped by those illegally occupying their land or property filing suits against the legitimate owners. Weak and unclear title deeds, loopholes in registration procedures and unreliable transfer mechanisms have fortified propensity for unnecessary litigation. In large urban areas, organized land mafias have taken illegal possession of large tracts of state and private land parcels. Building Control Authorities such as CDA, LDA and KBCA have become hubs of corruption where lower functionaries would create hurdles at every stage of construction and won’t issue the Building Completion Certificates unless they are paid huge sums as illegal gratification. Multi billion dollars worth of investment is stuck and has become illiquid because of these factors.

Finally, most of the problems in the operation of the Public Sector enterprises arise due to widespread favoritism and nepotism in the appointments of the Chief Executives and the Boards. The process of their appointment is highly opaque and depends upon the whims of the Prime Minister or the Chief Minister who enjoy enormous discretionary powers. These powers have been mis-utilized to favor the cronies of the rulers. To avoid this tendency and introduce transparency the Chief Executives (CEOs) and the Board of Directors for 100 key economic institutions, organizations and corporations should be appointed for a fixed tenure in a clearly defined process. Once appointed they cannot be arbitrarily removed without cogent reasons. These appointments should be placed and endorsed by the Parliamentary Committees and the removal can be challenged in the higher courts of law if done with malafide. These CEOs should be given specific targets and held accountable for results. The Annual Reports of their performance and financial statements should be submitted to the Parliament and made public. Those who consistently fail to meet agreed performance goals without any justifiable reasons should be taken to task.

The political will to carry out these above decisions has been lacking so far. It is time that the government and the mainstream political parties should sit together, muster the courage, rise above narrow partisan interests, develop a consensus on the long term economic direction and get the country out of its present crisis and a general state of despondency. This consensus will provide the link between exit from the present situation and the resumption of long term economic development of this country.

1. Lecture delivered at the Applied Economics Research Centre (AERC), Karachi on March 1, 2011. [↑](#footnote-ref-1)