

## **WHAT DOES CONTINUITY OF REFORMS MEAN?** **ISHRAT HUSAIN**

Several leading newspaper editorials, informed commentators and political analysts have taken umbrage to the State Bank's constant pleading to continue economic reforms in the country. A group of leftist oriented writers identify these reforms with the conditionalities prescribed by the international financial institutions (IFIs) have serious ideological aversion to these institutions and find them as convenient scapegoat for ventilating their anti-capitalist and anti-globalization sentiments. This group can be ignored as no amount of argumentation, evidence or persuasion that these reforms are not spurred by the IFIs but are driven by the larger interests of Pakistan will change their closed minds. To them, everything supported by IFIs is black, conspiratorial, self serving (to pay themselves back) and against the poor and downtrodden masses of developing countries. There are no grey areas or nuances or shifting paradigms as far as they are concerned. If we tell them that Pakistan intends to pay these institutions ahead of schedule they will find some other excuse to blame. I will therefore leave their rhetoric, fulminations and outbursts aside.

There is a second group of serious minded nationalistic oriented writers who believe that the reforms implemented during the last three years were harsh, onerous and adversely affected the poor and the middle class. To them, continuation of reforms is synonymous with the continuation of past hardships and

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erosion of purchasing power faced by the ordinary Pakistani during the last three years. Their criticism is more valid and needs to be addressed adequately.

First, a country faces different phases of economic transformation through which it passes through and chooses a different set of economic policies for each phase. Between 1999-2002 Pakistan had to stabilize its economy, get out of the ever impending payment crisis situation, turn the fundamentals around and lay down the foundations for sustainable growth and poverty reduction. Those who believe that we could have succeeded in reducing poverty or accelerating growth in absence of first achieving stability, getting out of debt trap and assuring good economic governance are sadly mistaken. Prime-pumping by the government and opening the doors of government departments and corporations to large scale employment or providing subsidies on petroleum, electricity, food etc. would have been a short-lived blip in the economy but was not simply sustainable. This approach would have certainly accentuated inflationary pressures in the economy, depreciated rupee to over 70 per dollar, increased the debt burden and accelerated flight capital. Short-term gimmickry for gaining political kudos has been tried in the country before but was not successful either in maintaining political support or improving the economy. The reforms which were required during the phase 1999-2002 were no doubt harsh on general public but they were necessary. Had the previous governments taken the right decisions on the right time to set things on the course this severity could have been avoided. But the Military

Government had to take all the tough decisions which were avoided in the past and the cumulative impact was necessarily quite unpalatable.

Second, the current phase (2003-2005) whereby the real economy is beginning to pick up as revealed by the various indicators does not require that the same set of reforms which were pursued in the past three years have to be continued. This phase requires a completely different set of structural, sectoral and micro reforms rather than the price reforms, fiscal squeezing and monetary tightening observed during first phase.

As there is a great deal of ambiguity about the nature and contents of the reforms I will first like to elaborate as to what kind of reforms need to be continued in this current phase and the consequences they are discontinued.

- (a) Institutional reforms of WAPDA and KESC: As both these entities are creating problems for fiscal discipline, burdening the consumers and affecting the competitiveness of industry, they need to be restructured, unbundled and made more cost efficient. Thus discontinuation of ongoing reforms in these two organizations will pose a major macroeconomic risk and vitiate some of the gains made during the last three years. The purchasing power of the middle class will be eroded and the industrial cost of production will remain high.
- (b) Restructuring and reform of CBR: The ultimate aim of a fair, efficient and equitable tax administration is to widen tax base, reduce tax rates, eliminate multiplicity of taxes and minimize physical interaction

between tax payers and tax collectors. The reforms initiated in last one year for restructuring of CBR are still in infancy and need to be nurtured. If these reforms are aborted none of the aims of the desired tax administration will be achieved. We will be stuck with an inefficient, inequitable system with a narrow tax base and the usual complaints of extortion, harassment.

- (c) Financial sector reforms: The banking system in the country has begun to show some signs of vitality and strength. Intermediation costs are on a downward path; portfolio of non-performing loans is shrinking; asset diversification has started to show some healthy trend; professionalism rather than connections is taking hold in management. But still the reforms have a long way to go. Mortgage and consumer financing to middle income classes, assistance to SMEs and agriculture are at very low levels and have to be stepped up. If these reforms are no longer pursued the benefits will remain confined to a small class of corporate and trade businesses and thus opportunities for expansion of economic activity, credit to middle class and new job creation will be missed.
- (d) Privatization: A number of public sector enterprises (PSEs) have been haemorrhaging the country's finances. Three years ago their annual losses funded out of budget were Rs 100 billion. These losses have come down but they still amount to 1 percent of GDP. These

enterprises produce goods and services and can be run efficiently only by those who know how to operate businesses and not by bureaucrats. If this budgetary allocation to meet the losses of PSEs is diverted towards education and health the benefits to the poor of this country will be enormous. In case we have cold feet and decide to abandon privatization it is quite certain that the budgetary subsidies to public enterprises will keep rising and leave little resources for social services and infrastructure.

- (e) Fiscal discipline: One of the main problems faced by the economy which made us highly vulnerable was the rising gap between our income and expenditure. We kept on borrowing internally and from international financial institutions to bridge this gap until the burden became unbearable and our economic sovereignty was compromised. In the last few years strict fiscal discipline has allowed us to reduce our external debt burden. If we once again begin to indulge in bad practices of the past we will soon be faced with financial crises and will have to run to international financial institutions to bail us out. Fiscal discipline does not mean squeezing of government expenditure but a reallocation towards development expenditure and social sectors along with higher tax collection. The subservience of our economic decision making to external agencies is something every patriotic

Pakistani should avoid. The only viable way out is to maintain fiscal discipline.

- (f) Good governance: Pakistan had earned the distinction of being ranked as the second most corrupt country in the world. The waste, leakages, favoritism and nepotism have cost the country a huge fortune. Some semblance of good governance was established during the previous government. If merit, transparency and level playing field are given up in the name of expediency the country will be faced with widespread disaffection and social instability.
- (g) Agriculture sector reforms: Productivity in agriculture sector is still low and the use of water resources and other inputs is inefficient. Farmers were not paid international prices for their output and small farmers were denied credit. Subsidies in agriculture were misutilized by the influential and well-to-do farmers. The reforms introduced to boost incentives, invest in rural infrastructure and expand credit to agriculture need to be further strengthened. If for some reasons these reforms are not implemented there is a serious danger that the country may once again become a net importer of food.
- (h) Reforms in social sector: The devolution of powers to local governments is aimed at empowering the people at the grass roots level to make choices about essential services such as education, health, water supply, farm to market roads, land leveling, water course

improvement. The demand-driven projects responsive to the needs of the local people will produce better outcomes as far as social sector development is concerned. Any move inspired by power grabbing considerations, to dilute the devolution will have very negative repercussions for poverty reduction and provision of social services. Of course, the flaws and deficiencies in the existing system should be rectified but no attempt should be made to bring about status-quo ante.

- (i) Civil Service, Police and Judicial reforms: Although some initiatives have been taken to reform the main executive and judicial organs of the state not much progress has been made. Merit based recruitment, performance linked promotions, adequate compensation, continuous upgradation of skills and knowledge are some of the essential ingredients of these reforms. No doubt they will be met with fierce resistance but involvement of all the stakeholders in the design and implementation process will neutralize this opposition. But if we decide to abandon this path and do not bring about the required changes our institutional capacity to deliver justice, services and protection to the ordinary citizens of Pakistan will be severely impaired.

In the end, I would therefore ask the following question? What is wrong with continuing the above set of reforms in the next 3 years? They will relieve us of the burden of excessive pricing of our utilities; ease the harassment and

extortion of tax collectors; make our banks more accessible to the middle class, farmers and small businesses; get rid of unprofitable public sector enterprises; minimize corruption and nepotism; improve the productivity of agriculture; transfer powers of providing essential social services to the local governments; increase our education and health availability while improving their quality and make our civil service, police and judiciary more efficient and responsive to the needs of the common man. I doubt if any one will disagree with the thrust of these reforms. They may differ on the modalities, instrumentalities and sequencing, phasing and timing. But a three year period is too short for such an ambitious and comprehensive set of reforms to take hold. At least next 10 years should be devoted to get them implemented in the right way.