The 'awam' and reform

Ishrat Husain Published January 22, 2023 Updated a day ago

The writer was part of the team that negotiated the two IMF programmes successfully implemented in 2000-2004.

Pakistan's economic situation requires fresh thinking and a clear approach. The blame game where each incoming government passes the buck to its predecessor has reached saturation level. People expect the incumbents to show them the path of relief to resolve their present difficulties, particularly inflation. All governments are scared of taking tough, but necessary decisions, for fear of alienating the awam (public), attacks by the opposition

parties and media, and erosion of their political capital. Let's see how this fear is misplaced.

The adjustment path to stabilising the economy (structural reforms) to resume sustained growth requires the fiscal and current account deficits to be reduced to manageable levels so that they can be financed without recourse to exceptional financing from domestic lenders, the IMF and other creditors, and maintain a reasonable level of reserves. The path to reducing the CAD is through maximising forex earnings by promoting exports, attracting FDI and facilitating remittances. This requires minimising protection for domestic industry so that producing for export markets becomes more remunerative. Such an approach would give relief to the awam from high indirect taxes, while the expansion of the export sector and FDI would generate more employment.

On the fiscal front, the way is to mobilise taxes from sectors, businesses and individuals outside the tax net, privatise or restructure SOEs, especially energy companies, shift to targeted subsidies and undertake pension reform. The burden of additional taxes would not fall on the awam as they are already exempt from paying direct taxes. On the contrary, if large and medium landlords, businesses, real estate developers and owners are taxed, GST rates on essential commodities, that are borne disproportionately by the poor, can be lowered. Consequently, the manufacturing sector that contributes two-thirds of total taxes would also free up capital and expand capacity or enter new ventures. The reason why growth spurts lead to CADs is that the domestic productive capacity is inadequate to meet demand which spills over to increased imports. Employment would be generated directly or indirectly through new investment. Fear of broadening the tax base has nothing to do with the awam but with the loss of privilege enjoyed by elites leading extravagant lives and not paying taxes.

The other way is to privatise, lease out or restructure SOEs, which are straining public finances, in the form of investment, loans, grants, subsidies and guarantees. We should learn from the example of banks which were subsidised for their losses; after privatisation, they are paying about Rs200 billion in taxes. Across the board, subsidies on electricity, gas, fertilisers, petroleum products, wheat and administered prices have wreaked havoc in the form of circular and contingent debt. Energy companies should be opened up for competition at the retail level to benefit consumers. The 'single buyer single seller' model should be replaced by multiple sellers and multiple buyers. Pakistan is fortunate to have the Benazir Income Support Programme for which all political parties deserve commendation. It should be used for targeted subsidies for energy, food and fertilisers, saving at least Rs300bn-400bn annually. The pay-as-you-go pension system should change to a defined contribution, avoiding the imminent explosion of the pension bill in the medium term.

Expressions of fear that reforms would hurt the people are a ruse to protect elite interests.

Additional taxes collected and savings accruing from the expenditure curtailment should boost access to health, education, nutrition, water supply, sewerage etc. The Sehat and Kisan Cards, educational stipends, school lunches, private-public partnerships in education and healthcare are potential avenues for ensuring this access. Enhancing agricultural productivity by investment in R&D, rural infrastructure and input supplies can stop the drain of almost $7bn-8bn in the import of farm commodities. Provincial governments, which can add Rs500bn-Rs600bn in revenues annually, should devolve these subjects to local governments, earmark financial resources and delegate powers to tax property, fees, cess and user charges to this government tier, while formulating policy guidelines, monitoring outcomes and auditing accounts.

This sketch indicates that the loud expressions of fear that reforms would hurt the awam are, in fact, a clever subterfuge to protect the interests of the elite that is represented in decision-making positions — politicians, bureaucrats, military officials, big businesses, large landlords, judges, etc, who benefit from the status quo.

This discussion leads to the next question: what is the appropriate mix and sequence between adjustment (reforms) and financing under the IMF programme? Adjustment can be front-loaded — tough decisions are taken prior to the executive board's approval and financing is staggered and spaced, according to the pace of adjustment. The other option is to inject substantial financing fairly early to ease liquidity pressure, reconstitute reserves and allow adjustment measures to follow. The executive board's stance depends largely on borrowers' track record. Pakistan, a long-time borrower, has a poor record with low credibility; so, the onus falls on adjustment first and then staggered financing. The three-year programme would have 12 reviews. Only the successful completion of a review can trigger the release of a tranche each quarter. Performance criteria and structural benchmarks are agreed with the borrower to monitor progress. The latest data is evaluated to make any modifications. Adjusters and waivers are used to reflect deviations from original programme assumptions.

But Pakistan's economic managers want to get financing first and delay some conditionalities. Seeking financing from friendly countries and then approaching the IMF board to relax timelines for implementing prior actions is an attempt to ease the liquidity pressure. However, external financing requirements under the programme already incorporate these amounts; the Fund may agree to advance disbursements but it would hardly make a difference as these are not additional amounts. The cost of postponing the adjustment measures is increased uncertainty and distortions which may lead to even tougher policy actions. We are already witnessing the hoarding of dollars, and parallel markets are discouraging the inflow of export proceeds and remittances, thus decreasing the supply to the inter-bank market and widening the spread between the official and unofficial markets. We need a statesman-like leadership, willing to put its own stakes on the line in steering the economy towards the right track, servicing debt, getting rid of overdependence on the IMF and avoiding the drift from one crisis to another. Other countries have done so. Why can't we?

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