**Keep the dollar flying**

BY R I A Z R I A Z U D D I N 2021-10-09

KEEP the dollar flying (ie keep it relatively expensive). Why? Why not keep the rupee flying (ie keep it relatively overvalued)? There are very simple reasons to prefer the former approach over the latter to keep our economy flying, rather than having a crash landing. To understand the reasons, imagine you are a businessman with two choices.

The first choice is to start an import business. The second is the export business. Which one will you choose in our country? Import or export? Many will choose (and are still choosing) the import business because it requires little investment and is much easier to set up. Very few will choose the export business because it requires huge investment and is difficult to set up. Is it too difficult to see this ground reality? This is one of the primary reasons to keep the exchange rate more favourable for exporters. Keeping it consistently more favourable for exporters also helps producers, thereby promoting industrial growth.

For decades and beginning in July 1949, hardly eight months after the death of the Quaid our policymakers chose to deliberately keep the rupee overvalued by not devaluing it despite the UK having devalued the sterling by 30 per cent. All Commonwealth countries did so except ours. The pound sterling became cheaper in Pakistan, and import dependency began under the guise of the then fashionable `import substitution strategy`.

Since then, our country has been on a trajectory of faster import growth, slower or stagnant export growth, mounting external debt necessary to finance the gap between imports and exports, and consequently boom-and-bust cycles of growth.

Our exchange rate has historically favoured importers at the expense of exporters. Yet we continue to lament our poor export performance. we seem to prefer the easier approach of lamenting rather than taking the difficult decision of keeping foreign exchange consistently expensive. Should we also congratulate ourselves on our extraordinary import growth performance? Our politicians, policymakers, bureaucrats and many economists (of national or media repute) continue to deludethemselves that the expensive dollar is mostly the work of speculators, and needs to be stabilised (a euphemism for keeping the dollar from flying, or keeping it nearly fixed).

Many economists continue to provide strange arguments such as `depreciation leads to increase in debt`. They fail to see that by not depreciating in time, we fuelled import consumption in the first place, which was mostly financed by increasing the external debt. Many still believe that exports do not respond to the exchange rate, based on silly econometric regressions. The fact is that exports respond slowly to depreciation compared to imports because of the reasons stated in the first paragraph. Many continue to say that the import content of our exports is very high, but never question why it is high. It is high primarily because of the mostly consistent historic favourable exchange rate for imports ie the overvalued rupee.

Pakistan established a `managed floating regime` in 1982. As a result, our trade balance improved between 1982 and 1998. Had the rupee shown more flexibility in the exchange rate during this period, our country would have developed a strong, diversified export base. Moreover, one would have expected a better trade balance performance when the Pak rupee was officially `floated` in 2001. But soon after, the fear of floating set in ferociously in the minds of policymakers and the rupee hardly moved from about Rs60 to a dollar (from 2001 to 2007), making it a `de facto peg` putting the economy again in the pre-1982 fixed exchange rate regime.

This fear of floating, benefiting importers at the expense of exporters, played havoc with the trade deficit, and the economy crashed with the onslaught of the global financial crisis of 2007-08. Foreign exchange reserves vanished quickly. The IMF helped stabilise the economy and the rupee became somewhat flexible again from 2008 to 2013. Fear of floating set in again and the dollar was deliberately kept cheaper between Rs98 and Rs104. The story repeated itself. Trade deficit rose and reserves depleted. What was mind-boggling was how the`savings` from the dramatic fall in the international price of oil (from $100 per barrel in 2012 to $40 in 2016) were wasted in supporting the rupee and increasing imports. No wonder exports declined or stagnated during 2013-2018.

The IMF helped again. The rupee showed flexibility and the economy was stabilised. The State Bank introduced a sensible mechanism of `marketdetermined exchange`. Now, as of Oct 2, 2021, the fear of floating seems to have set in again. This fear is evident in the remarks of Finance Minister Shaukat Tarin that the dollar should cost no more than Rs165, instead of the current market value of close to Rs 172. This fear of and disdain for flexibility is not new and had been shared by most (if not all) of our past finance ministers. Sadly, this fear is also reflected in the remarks of various economists of national repute.

As a result, the State Bank will undoubtedly come under pressure to intervene. If this happens, it will lead to depletion of reserves leading to another balance-of-payments crisis. I hope this does not happen. I wish the State Bank will be allowed to do its job independently. Our prime minister is a courageous man. He has asked all Pakistanis to not be afraid of so many things. May I now respectfully implore him to not be afraid of the rising value of the dollar? Trust the State Bank of Pakistan in managing the exchange rate independently. Very few public-sector institutions can claim a competent staff and an experienced and knowledgeable board of directors like State Bank. Let the rupee float. It requires tremendous and continuous patience to lessen dependency on imports, promote exports, enhance reserves and contain the external debt. If wishes were horses, our country would surely be an Asian Tiger now. If the wishes of the finance ministers become the horses of the State Bank, our country is unlikely to come out of the boom-and-bust cycles of economic growth.  The writer is a former deputy govemor of the State Bank of Pakistan.

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