

# The economics of 2002

By Frank R. Kardes

2002 was a very interesting year for Pakistan on the economic and political fronts. The most significant change has of course been the reintroduction of a democratic political order in the country. The process is not yet complete, but with the Senate elections to be held in January 2003, the formal transition to democracy should be done with very soon. What this leads to and implies is another thing, and we will leave that for political scientists and analysts to figure out. We will focus more on the economic issues.



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The economic situation had not been great even in 1998 when we went ahead with the nuclear explosions and then had the Kargil adventure. Things did not improve substantially over the next couple of years, and initial reactions to 9/11 were that even more difficult times were ahead of us. But things have so far not been as bad as had been initially envisaged. There is no doubt that our exports and imports have been hit, and prospects for attracting foreign investment have remained rather dim, but the disaster that was initially predicted and foreseen by some, has not come about, or at the very least has not transpired to date.

In fact, to the contrary, whatever the political impact and the long-term consequences of 9/11, they have provided Pakistan with interesting breaks on the financial side. The main benefits have accrued in the form of direct financial assistance from the USA and other allies for budgetary support, expenditure on important areas like education and security, defence-related equipment, and to allay the costs that Pakistan was and is incurring on the 'war on terror'. Other benefits have included the more 'understanding' attitude of the multilateral agencies like the IMF, the World Bank and the Asian Development Bank, the Paris Club and other consortium and individual lenders and donors. This has allowed Pakistan the space to renegotiate its debt portfolio to acquire quite generous breathing space on the whole. This breathing space has not only included some write-offs, it has also allowed Pakistan a period of a decade or more on some of its loans before start of repayment. In some cases the interest rate on some of the loans has been reduced as well.

The 'war on terror' has also had some undesirable consequences for Pakistanis. It has been harder for them to travel abroad, keep money and investments abroad, and to use informal channels for transferring money across international frontiers. All of the above have helped Pakistan, and the State Bank of Pakistan has been smart enough to take advantage of the situation. As more dollars made their way to Pakistan, the State Bank was able to pick them off the kerb market, without affecting the exchange rate by much. Though the multilateral agencies were not happy about the situation and have now asked the State Bank not to intervene too heavily, the State Bank was able to take away \$3-4 billion off the market. This allowed the Bank to develop some reserves when we badly needed some. At the same time the switch from 'hundi' to official channels and the removal of the difference in the official and the kerb market has helped the banking system in Pakistan to cater more of the foreign exchange transactions.

private and public banks in Pakistan.

The fiscal space provided by debt renegotiation, write-offs, the inflow of funds and the build-up of reserves have lifted a lot of pressure off the government. The Government of Pakistan is now not worried about how it is going to make the next payment and how it is going to meet the next obligation. It has also allowed the GoP to pay off some of the more expensive short-term debt so that the overall debt liability as well as the interest burden can be further brought down. The move to longer-term debt makes sense since Pakistan is likely to use most of its debt for longer-term projects. Recently some of the rating agencies have also upgraded Pakistan's debt rating. This, of course, reflects the improved financial position discussed above.

Inflation rates have been low in Pakistan for a few years now, and will continue to remain low in the near future. This has also allowed the State Bank to bring down interest rates. With a recession in the real sector, better management of the exchange rate, and a more prudent monetary policy, it is not surprising that inflation has come down. The low inflation too will help the State Bank as it can continue to lower interest rates for the moment, without fearing a surge in inflation.

For the near future things are likely to remain favourable on the monetary front. There is no reason to believe that the \$9 billion reserve can disappear very quickly, there is no reason to believe that overseas Pakistanis will not continue to send remittances back to Pakistan, there is some reason to believe that Pakistan will be able to attract some sector specific investment in sectors like oil and gas, and given the international situation, it seems that the US and the West in general will continue to support Pakistan monetarily in the near future as a quick end to concerns about terrorism is quite unlikely.

But it is the continued slow performance of the economy that should be and is of great concern.

way below where it should be), and unemployment as well as poverty continue to be the main problems that we face today. Agriculture will show better performance this year, but largely due to better availability of water. The situation can be very different next year again. We have not even begun to address the water management issue seriously as yet. All calculations of poverty are showing that it has increased in the last decade. Inequality measures show that inequality has increased significantly over the same period. Even though we do not have the figures for the last year or so, there is no reason to believe that the trend of the last decade has been arrested or reversed in the last year or two. The GoP and the State Bank of Pakistan have to turn to the real sector now to diagnose and fix its problems.

/Some of the financial sector experts in government have been arguing, for the last year or more now, that since we now have stabilization on the monetary side, growth will come back very soon, and will be more sustainable this time round. These experts have faith in lower interest rates, a stable exchange rate, and a privatization programme as a generator of growth, but it is hard to buy this argument. Not only is it a fact that there is hardly any country in the world that has been able to get out of the morass of underdevelopment through only the above policies, it is also the case that we have not tackled any of the structural problems that had led to the crisis the last time round. How can we then argue and believe that stabilization will lead to sustainable growth this time round?

Fiscal deficits are still quite high, debt is still large, there has been no real breakthrough in exports, no change in our revenue generation ability due to failure of reforms in the Central Board of Revenue, no change in the area of infrastructure or utility provision (WAPDA is the main bottleneck here), little change in the levels of corruption and red-tapism in government circles, no change in the bureaucratic setup or mindset, and no change in our ability to guarantee property rights and the delivery of fair, transparent and speedy judicial services.

How can we then argue that stabilization achieved with a decade of recession and neglect of development expenditure will lead to growth?

The human development indicators for Pakistan are quite appalling. We have low literacy, high infant and maternal mortality, high incidence of malnutrition, low enrollment rates in primary and high school education, high dropout rates, high levels of morbidity, high population growth rates and low life expectancy compared to even some of the countries in the region. How can we cover this social gap? The gap was there at the start of the decade of the 1990s too, but the successive governments' reductions in development expenditure has made the situation much worse. How can this populace achieve and maintain high levels of sustainable growth?

The Jamali government has promised relief in the form of subsidies and has started by announcing a 12 paisa per unit cut in electricity prices. But the problems mentioned above are too deep rooted to be resolved by such moves or pronouncements. 2002 has been a difficult year for the people of Pakistan. Despite some positives that have resulted or have been achieved, there is a lot that was left undone in 2002. This suggests that 2003 will also be a difficult year for the people of Pakistan.