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The political economist

For substantive reduction in poverty, the state will have to be structured very differently. It will have to divert resources as well as services to citizens as a matter of right. This will require a radical re-ordering of the state. Otherwise all talk of addressing the poor will remain mere shop talk

By Shahid Husain

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In an interview with TNS in Karachi, he explained in detail the state of Pakistan's economy, impediments in containing various crises and how the poorest of the poor could be provided some solace. Excerpts follow.

The News on Sunday: The government says there are visible signs that the country's economy is improving. As an independent



economist how do you assess the performance of PPP government after it assumed power?

Asad Sayeed: Before I assess the performance of the government on the economic front, let me provide some context. First, there is a consensus towards market-based solutions to economic issues in Pakistan – termed as 'neo-liberalist' thought – across party lines and amongst different elements of the state. The present government is no exception to this. Second, the economic situation inherited by the government as well as the subsequent downturn in international economy has made the task of economic management all the more difficult.



With these caveats, on balance, the government has done a good job in my view. The macro economy was staring down the barrel six months into the government taking over, essentially because of an unprecedented increase in international oil and commodity prices. It will be useful to recall that in September and October 2008, the Pakistani rupee was in a state of virtual free fall, reserves were depleting very fast, the current account and budget deficits were ballooning and inflation was over 25 percent (food inflation was around 32 percent). There was also a great deal of uncertainty as bilateral donors were not forthcoming to help Pakistan individually – a help that was expected at the time as the 'democracy dividend' – and pushed Pakistan into an IMF agreement. A year and a half later, we see that the macro economy has been stabilised. Inflation has been halved and external and internal imbalances have been brought under control, albeit with the help of the IMF. This is no mean achievement.

Other than macro economic stabilisation, in three other areas the government can legitimately take credit. The first is social protection. Allocations for targeted social protection were increased from Rs11 billion in 2007-08 to Rs34 billion in 2008-09 and then to Rs70 billion in 2009-10. This increase was entirely due to initiation of the Benazir Income Support Program (BISP). There is a lot of cynicism about BISP and there are issues with targeting that need to be sorted out, but early evaluations show that by and large transfers have gone to the poor. Moreover, the poverty scorecard is to be introduced soon for targeting purposes and that should ensure, to the extent possible, that benefits reach the poorest of the poor. Of course there will be exclusion errors but on the whole allocation of resources towards the poor signifies a substantial redistribution of incomes initiated by the present government.

Second, the successful agreement on the National Finance Commission Award (NFC) is also a significant achievement of the government. This is the first award in the last 19 years that has been accepted by all protagonists as well as the general public. Distribution of resources across provinces and between the Centre and the provinces has been a thorny issue in Pakistan. Either the federal government or the Punjab has been reluctant to share resources with smaller provinces in the past. In the recently concluded NFC, the federal government has taken the biggest hit in assuaging the smaller provinces by reducing its share of resources by more than 10 percent. The Punjab government should also be credited for agreeing to relent on the horizontal distribution

formula. The important lesson is that federalism in Pakistan can only be ensured through negotiations and a spirit of compromise that democratic governance can create.



Third, this government has moved some way in reviving agriculture and consequently addressing the issue of food security in the country. We will do well to remember that when the present government took over, there was a severe shortage of wheat in the country. This was because of a particularly bad wheat crop in the previous year and the then government's blunder of exporting wheat in a year of shortage. In fact, throughout the Musharraf years, there was a pronounced urban bias in agricultural pricing. Support price for key food items were kept low, essentially to benefit urban consumers with the result that there was a net transfer of resources from rural to urban areas. By increasing the support price of wheat from Rs450 per maund to Rs650 in March 2008 and then to Rs950 per maund later in 2008, a significant boost was provided to food staples production in particular and the rural economy in general.

While the policy direction is right, because of water shortages and volatility in international commodity prices, food insecurity will continue to haunt us. But this is not because of policy failures as such.

TNS: What have been the government's failures?

AS: There have been a number of errors of omission and commission. There are three areas in which policy failures are obvious and two where the failure is circumstantial.

The most salient failure of the present government has been in tackling the electricity shortage. While it is correct that the problem was bequeathed to them by the Musharraf Government, the short term solution to the problem seems to have been mishandled. The problem of circular debt should have been addressed upfront and on a priority basis. Because this problem was mishandled, today we are working below the level of installed capacity and installed capacity itself is way below actual demand.



While the decision to induct Rental Power Plants (RPPs) was the only option if electricity was to be acquired in the short run, allegations of corruption and apparently weak contractual terms with service providers have marred the process a great deal. On top of that, the Minister for Water and Power kept claiming for a year that loadshedding will be eliminated by the end of 2009. This has further eroded the credibility of the government in delivering the service.

The second area where the government has so far not taken any significant initiative is on social sectors. While much of the onus of social sector development rests on provincial governments, the federal government has reduced its own allocations on health and education.

More importantly, the federal government's mandate is to provide policy direction to the provincial governments and create regulatory

structures. The government has performed abysmally on this front so far. The education policy has been announced and we are told the health policy is on the anvil also. The education policy seems like a routine bureaucratic regurgitation of past policies and what one has seen of the draft health policy there seems nothing in it that addresses the perennial problems in health sector delivery either. At a time when the deadline for the MDGs is closing in (deadline is 2015) and Pakistan suffers from a huge deficit in social development, this neglect is costly.

The third area where there has been very little progress is in giving a direction to the manufacturing sector. Granted that we are in a recessionary situation and that past governments have not been attentive to changing the structure of manufacturing in line with changing demand patterns, both nationally and internationally, the present government has taken no policy initiative in order to provide a direction. Moreover, taxation has been manufacturing intensive for long and this trend has, if anything, been intensified in the last two years.

There are two other areas where there has been criticism on the government. These are petroleum pricing and tax collection. While much of this criticism is unjustified, the situation could have been better managed. When the media creates a ruckus on increasing petroleum prices, it overlooks the fact that Pakistan imports the bulk of its petroleum products and that the trend in world market prices will be reflected in domestic prices. In market economies, it is never a good idea to provide blanket subsidy on products as ultimately someone has to pay for this subsidy. We saw in the last days of the Musharraf government where subsidisation of petroleum products led to an unprecedented increase in money supply and consequently in runaway inflation. So what was provided as subsidy by the previous government was taken back from the public in the form of reduced purchasing power.

Where the government could have managed things better is by cross subsidising diesel. The price of diesel for the first time perhaps in the country's history has exceeded the price of petrol and as we all know diesel fuels long haul transportation as well as public transport. The government argues that since there is no diesel processing facility in Pakistan, all diesel is imported and consequently its aggregate import cost is more than that of petroleum.

And since the government has decided to eliminate subsidies in the sector, the market dictates that the price of diesel should be higher than that of petrol. We, however, know that the greatest impact on aggregate prices and particularly prices that affect the poor is through the price of diesel. To lessen the impact on the weaker sections of society the government could have increased the price of petrol more and subsidised diesel by the margin of the premium charged on petrol. In other words, petrol consumers could have been taxed to subsidise diesel users.

Revenue generation is another area where policy could have been better tuned. Again some of the popular criticism on this front is false. Economic logic suggests that in recessionary times revenue



falls. At any rate revenue is not expected to increase when growth has decelerated from an average of 6 percent to 2 percent in the last year. However, what the government has failed to do in the last two years is to broaden the tax rate. One of the biggest issues for Pakistan's economy is the lack of documentation and significant leakages that exist. Most salient in terms of lack of documentation is a large chunk of the services sector. Doctors, lawyers, accountants, security companies, private schools, colleges and hospitals, not to mention stock trading and the real estate business, are all outside the net of sales taxation.

While it is appropriate that commodity production – such as industry, agriculture and construction – should not be taxed in the midst of falling output, the government could have taken some incremental steps to broaden the taxation net to other services. The reason for this error of omission perhaps is that the government has been unwilling to take on influential lobbies that represent these sectors.

TNS: You have given the balance sheet of the government in great detail. You have also said that the government has managed to reduce inflation but the fact is that food prices are still very high. Take the increase in the price of sugar for example which was allowed to balloon simply because sugar mills owners are politically influential.



AS: The sugar crisis is a perfect symptom of the structural problems that afflict Pakistan's economy and its vulnerability to global developments. The sugar crisis started with the international price of the commodity trebling in a few months. Pakistan had a good crop of sugarcane last year and the price was under control. Once the international price jumped, the incentive for the Pakistani producer as well as the speculator to export the commodity to India (where there was a shortage) was suddenly created.

The fact of the matter is that Pakistan's economy is unable to insulate itself against world market prices, especially for food items which can easily be transported to India or Afghanistan (and from there to Central Asia). Once the prices started to increase, the government negotiated with the producers to release sugar at an acceptable 'middle way' price.

But then the Supreme Court intervened and decided to 'fix' a lower price. The result was that hoarding increased even more, sugar disappeared from the market and prices jumped even further. Moreover, given the 'harassment' that sugar producers faced at the hands of the Supreme Court and the Punjab Government the millers have bought less cane and will produce less sugar next year. As such, we are going to have further shortages.

The government has been criticised for not regulating the price as sugar millers are influential politicians. While it is true that a large number of sugar millers carry political clout, it is also a fact that the sugar industry operates as a cartel. As such, most of their decisions (to sell or hold the output and what price to buy it from the farmer) are coordinated. In that sense, they are no different from the banking, the auto, the cement and a host of other industries in



Pakistan that operate as cartels and have less direct political influence.

The fact is that the state in Pakistan does not have the regulatory and administrative capacity to regulate prices, break cartels and to curb smuggling. As a result, such crises are going to recur unless the state gets its act together.

On a more ominous note, the reality is that food price inflation in a number of developing countries and in Pakistan has been high over the last few years. For a variety of reasons, food prices globally have seen wide fluctuation over the last few years and are expected to remain volatile in the near to medium term. While government and states can prepare for these eventualities to a degree, unfortunately the people will have to bear the brunt of volatility in world prices.

TNS: Foreign Minister Shah Mahmood Qureshi has suggested the possibility of leasing agricultural land to Middle Eastern states. How will it impact the farmers and the agrarian economy of Pakistan?

AS: This is a wrong policy and should be nipped in the bud as soon as possible. In a country where food shortages have become endemic as we discussed earlier and where employment in agriculture is still substantial, this policy will only invite further social dislocations.

From statements of different ministers, it is not clear whether the government intends to sell developed land to foreigners or hitherto uncultivated land which will be developed for them. In any case, water and other scarce resources will have to be diverted to these lands away from already cultivated land. Moreover, corporate farming works with fewer workers and more capital intensive equipment. This will create further dislocations of workers, particularly in a situation where the rest of the economy is not expected to grow fast enough to absorb these workers.



Another danger I see of this policy is the impact it will have on the socio-political milieu. Most if not all of this investment is expected to come from Gulf countries and we know that in the last 30 years these very countries have bred a certain form of sectarian and militant form of Islam that has made us a violent and intolerant society and brought Pakistan globally in focus for harbouring terrorism. It is thus best to keep Gulf investors out of the rural areas of Pakistan if we are to shed the terrorist scourge in our body politic.

TNS: The government has again decided to give a raise to armed forces personnel. How are defence allocations impacting growth and affecting health and education sector?

AS: Well unfortunately the armed forces have a claim right now on resources given the campaign against terrorism in the north-west. Obviously every rupee spent on defence is a rupee taken away from social welfare and productive activity.

The more important point, however, is not whether defence

allocations have been increased this year but that the defence budget remains outside the ambit of 'civilian' accountability. There is still no debate on the military budget in parliament and the budget remains opaque in the sense that we do not have enough details of different heads within the military budget where the money is spent. As such, neither parliament nor others can point out where the inefficiencies and/or misconduct occur in the large amount dedicated to the military.



While the present government did manage to open the military budget slightly by disaggregating the budgets dedicated to the three forces, at this point it appears too weak to make this budget more accountable.

TNS: What steps should be adopted to bring solace to the poorest of the poor?

AS: I mentioned in the beginning that the power elite in this country – which also includes the PPP government – works within the realm of neo-liberal economic paradigm. Within this reality, the government can only enhance the net of social protection and reduce the rate of inflation to the extent that circumstances allow it to do so. But neither will bring substantive solace to the poor.

For substantive reduction in poverty, the state will have to be structured very differently. It will have to divert resources as well as services to citizens as a matter of right. This will require a radical re-ordering of the state. Our research shows that the poorest individuals and communities belong to marginalised ethnicities and caste groups. Political action will be needed to provide genuine citizenship rights to these marginalised groups. Otherwise all talk of addressing the poor will remain mere shop talk.