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Strategic economic reform

WITH Saudi Arabia’s help, the scope for adopting strategic approaches to economic reform independent of IMF has increased. Towards clarifying these, this article makes five points. One, that the budget and the balance of payments require separate attention. Two, that the immediate fiscal crisis isn’t too serious; but durable solutions require very difficult political initiatives — addressed also in an earlier article (‘The roots of our budget crisis’, The News, Sept 1). Three, that building external reserves requires innovative ‘strategic’ initiatives. Four, that beyond urgent financial concerns, important top-level guidance is needed on an economic strategy of sovereign development. Finally, that the present financial crisis is essentially a crisis of economic management that requires leadership, not bureaucratic solutions.

First, there is a misconception that the balance of payments is a ‘mirror image’ of the government budget; that the ‘twin deficits’ (the consolidated ‘budget deficit’ and the current account deficit on the balance of payments, the ‘external deficit’ for short) ‘reflect’ each other. The practical significance of this, if true, would be that once the budget deficit is controlled, the external deficit would also be controlled; so, nothing more would be needed to strengthen the balance of payments (other than leaving the exchange rate also to the market). But this isn’t true.

Conceptually, the budget deficit can be split into rupee and ‘dollar’ (really, foreign-exchange) components. Equally, the external deficit can be split into government and private-sector components. Now, the government external deficit (one part of the overall external deficit) should be a mirror image of the dollar budget deficit (one part of the overall budget deficit). So, a part of the external deficit does reflect a part of the budget deficit, but the overall external deficit isn’t a mirror image of the overall budget deficit.

Turning from concepts to data, the State Bank estimates suggest that the deterioration in the overall external deficit from 2014-15 to 2016-17 (2017-18 estimates aren’t available) reflects more a drastic (50 per cent) fall in the private surplus, than a (28pc) rise in the government deficit. Viewed another way, in the three successive years ending 2016-17, private surplus declined from 81pc, to 62pc, to 32pc of government deficit. Both theory and data therefore support the intuitive notion that fiscal policy alone won’t stem the pressure on external reserves.

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Second, in purely arithmetic terms the budget deficit seems manageable. By the latest provisional estimates, if the Rs7.5 trillion that ‘government’ (federal and provincial) spent during FY2017-18 is taken as Rs100, then their revenues were only Rs70, so they borrowed Rs20 from Pakistanis and Rs10 from foreigners. Of the Rs100 they spent, Rs27 was on current expenditures of provincial governments; Rs22 on development projects; Rs20 on interest payments (Rs18 to Pakistanis, Rs2 to foreigners); Rs14 on defence; and Rs17 on all other items combined. These aren’t frightening numbers. Although not recommended, a 5pc increase in revenues and a 10pc cut in all expenditures other than provinces, interest and defence, would have lowered the deficit to 5pc of GDP (Rs34.4tr).

But arithmetic targets can be achieved in many economic ways. The choice of which expenditure to reduce, and which revenue and financing source to tap, affects overall incentives to employ labour, use money, produce, trade and invest, differently. The economic impact of this arithmetic therefore can be much improved by: (1) working out, and optimising, the impact of fiscal decisions on and feedback from the balance of payments (and the wider economy); (2) exploiting potential gains from political engineering (especially, to contain the critical fallout from the 18th Amendment and the last NFC decision); (3) restructuring domestic debt; and (4) implementing appropriate reforms in civil and military operations and doctrines.

Third, shoring up falling external reserves — a more urgent, much tougher proposition — requires a strategic standstill-rollback approach. What is strategic? Following neoliberal IMF dogma, a non-strategic approach is to take the economy to be a machine and the task of policy to set the dials (prices and incentives) to the right setting, and let markets work their magic. Acting on the assumption that when government plans others plot (to foil those plans), is to proceed in a strategic manner. In this, a two-pronged approach — to stop further slippage (standstill) and to begin to regain lost ground (rollback) — may be considered.

By nature, strategies cannot be spelled out in advance. Under overall strategic guidance, tactical and logistic choices are best left to those responsible for execution. On the external finance front, two groups should be established. A 'standstill group' under the State Bank should meet on a weekly if not daily basis to stem capital flight, through durable changes in the external-payments regime and closer regulation of financial institutions. A second, inter-ministerial 'rollback group' under the commerce ministry (including autonomous and statutory bodies dealing with trade, finance and production), should monitor bilateral trade and payments with major deficit countries, and negotiate counter-trade, frame agreements and other innovative arrangements to reduce these deficits; in this, if the private sector is reluctant, public-sector solutions should be sought).

Finally, these fire-fighting measures to shore up public and external finances should be supported by a top-level group under the Planning Commission (or other suitable body) to design, implement and monitor a comprehensive set of long-term economic strategies and policies to recover sovereignty and start on the journey of government-supported development led by the private sector. This group should decide high questions of economic ideology — the role of plan and market, of monopoly and competition, public utility regulation, privatisation and state-enterprise management, etc. to provide much-needed guidance to both government officials and private-sector managers.

The financial and economic crisis is fundamentally a management crisis. Effective recovery and reform require leadership, which risk-averse status-quo bureaucracies are trained not to provide. There is a decades-overdue need to overhaul arrangements for national economic management — designed in the Cold War era to absorb Western capital for development projects. In the interim, quick action to revitalise the Planning Commission, to initiate strategic action to stabilise external finances, to seek political solutions to finance government, and to lay the foundations for sovereign national development are the need of the hour.

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