

Pakistan elections and aftermath



**WILL THE ECONOMIC CRISIS BE TACKLED
EFFECTIVELY?**

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Outline

2

- Major political and economic differences with the last time Nawaz Sharif (NS) was in power
- Dealing with the economic morass and political quicksand
 - Can NS pull it off this time?

Differences with the past

3

Political

4

- 1990s—nascent political process
- Governments booted out on allegations of incompetence or corruption
 - In reality—generating funds for electoral process
 - Rent-seeking: the original Mr. 10%; Swiss Customs pre-inspection cases (withdrawn by Musharraf)
 - NS dismissed by civilian President, as was Benazir (twice, once by a member of her own party); then
 - NS overthrown by Musharraf despite large majority in Parliament
 - ✦ Largely personal vendetta
- Now more mature system
 - NS played an elder statesman role in forcing restoration of the judiciary
 - Allowed the government to complete its term—without overturning apple cart
 - Collaborated in the passage of the 18th Amendment—
 - ✦ Devolving functions fully to provinces
 - ✦ More difficult for military to take over
 - ✦ But unfunded mandates and inadequate own-source revenue bases may heighten regional tensions

More dangerous neighborhood...

5

- 9/11 changed the calculus, as did the nuclear explosions in the 1990s (under NS's watch)
- Even with opening to India, will be difficult to significantly reduce military spending
 - Uncertainties with the end-game in Afghanistan
 - Now increasingly needed for domestic and counter-insurgency duties
- Growing regional polarization

Last five years....

6

- **Inept government at the center**
 - Embroiled in one corruption case after another, e.g.,
 - ✦ President on the reopening of the Swiss case (conviction, if it were restored, would have precluded Zardari's eligibility for the Presidency)
 - ✦ Involvement in IPPs (PM Ashraf)
 - ✦ Tainted drugs (PM nominee)
 - ✦ Haj scams (sub judice)
 - ✦ BISP—ineligible recipients on the rolls, leakage before the moneys were distributed; plus clientelism (for those correctly targeted)
 - Long hours of load shedding
 - Crowding out of the private sector, by bank borrowing to finance deficits

In contrast...

7

- Nawaz Sharif played the role of elder statesman
- While party in Punjab was efficient in the provision of education, improving infrastructure within its ambit
- And deflecting all criticisms to a bumbling and ineffective central government
- Biggest achievement:
 - Voters punished poor performance
 - Rewarded the relatively more competent party
 - ✦ Providing education, infrastructure and employment more appreciated than handouts and buying votes (e.g., BISP)

But needs to address the Economic Black Hole...

8

- Five years of stalled and low growth; energy crisis
- Failed tax reforms, lowest tax/GDP ratio in history
- Hemorrhaging reserves with repayments to IMF, incipient macroeconomic crisis, spiraling circular debt
- Weaker center
 - Post 18th Amendment
 - ✦ Exacerbation of regionalism given unfunded mandates—easy to blame the center (as PMLN did effectively from the Punjab)
 - Greater regional polarization
 - Made worse by PML-N effectively being largely a Punjabi party
 - ✦ PPP in Sindh and PTI in KPK have little incentive to make life easy for PMLN—in expectation that the latter's failure will make it simpler to capture the center the next time around

What needs to be done?

9

Is there a fiscal cushion?

10

- In 2008, Dar carried out an assessment of the government's balance sheet
 - \$10 bn in government bank accounts, when they needed to go to the IMF for \$8 bn
 - Establishment of a Treasury Single Account was initiated
 - But stopped a week later, as Dar was forced out of office
 - TSA was not implemented, despite a requirement under the Bank's structural program, now funds have grown
- Could provide a temporary respite, but would annoy serious vested interests
- Rationalization of subsidies and loss making SOEs
 - Key to addressing the circular debt problem
- Precarious reserve position, but not as dire as after the nuclear tests and sanctions

Focus of PMLN on self reliance

11

- **Good principle, but what is involved?**
 - Need to get the tax/GF ratio towards 15% to make the 7th NFC work
 - and 18%-20% to meet MDG's
- **Much talk about an agricultural income tax**
 - Welcome signal—especially since the feudals largely supported the PPP
 - Good to show seriousness, and signal that there will be no sacred cows—including supporters of the party (see below)
 - But limited revenue potential
- **Must address full range of tax reforms and improve governance**

But no alternative to fundamental tax reforms

12

- **Stop the cheating—all taxes**
 - Better use of information, especially from the GST
- **Fixing the GST is essential if there is any hope to get to 15% of GDP in the life of the next Parliament**
 - Will likely to continue to be opposed by key supporters of NS: the traders!!
 - Because they do not want to come under the radar of the FBS
 - ✦ More afraid of FBR extortion than payment of the income tax
 - ✦ Cultural problem needs to be addressed
- **Will need to clean up the tax administration**
- **Revisit the revenue assignments**
 - (current version very unstable—see recent paper on making the 18th Amendment work)

The big question....

13

- **Will NS be prepared to take on his own-supporters?**
 - Traders may be persuaded as their longer term benefits are dependent on NS being able to kick start growth and develop stronger regional trading ties with India and Central Asia
- **Will a more reasonable system of tax assignments be legislated to support the 18th Amendment?**
 - Will require statesmanship
 - Negotiating with bitterly opposed parties in the provinces
- **Failure will be calamitous for the unity of the country**
 - Yet the silver lining is that all parties (including PPP and PTI with national ambitions) will aim at the center through the political process
- **Can only wish NS all the best, as he takes over in a most difficult period of the country's history**