**Courting disaster for votes
By Dr Ishrat Husain**

Prime Minister Yousuf Raza Gilani is reported to have told the Pakistan Peoples’ Party (PPP) provincial assembly members from Punjab that the ban on recruitment in the federal government would be removed. Job quotas will be given to each Member Provincial Assembly (MPA) in addition to the substantial grants from the exchequer for development work in their respective constituencies.

This seems to be the first salvo fired by the government in preparation for the elections to be held in the next 12-15 months – if all goes well. These election-specific preparations should remind us of 2007 when a strong economy was allowed to derail because of the short-term political expediency of winning the electoral battle. The then government opened up the coffers of the exchequer and avoided critical price adjustments in order to win votes. These actions and inactions proved inimical to the health of the economy in subsequent years. How viable is this strategy of using public finances for winning elections?

Let us begin by examining in a cool and dispassionate manner the economic realities of Pakistan that are likely to confront us in the coming year. Global economic environment particularly the Eurozone is rapidly taking a turn for worse. Buoyant emerging economies that were propelling the world economy are also slowing down. The election year politics in the United States will not permit an amiable resolution of the impasse that will get the economy out of woods. Pakistan's exports and remittances did extremely well in the year ending June 2011. But the softening of cotton prices from last year's exceptionally high level has already begun to show up in decline in our textile exports in the recent months. Saudi Arabia, a major source of our remittances, is seriously thinking to place some maximum ceiling upon remittances that can be sent to home countries. Foreign direct investment and foreign private investment are not even dribbling. As we have chosen to discontinue the IMF programme, inflows from multilateral institutions are going to prove difficult. Loan repayments to the IMF will start from February 2012 and the grace period on Paris Club non-concessional loans would also come to an end. The US assistance to Pakistan for budgetary support has never been more than a drop in the ocean.

Domestically, Pakistan's growth rate remains anemic and level of economic activity subdued. Continuous dislocation because of the war against terror implies rising expenditures on defence and internal security. Debt servicing will preempt a large chunk of tax revenues. Floods in Sindh have caused a loss of $10 billion to the economy. Inflation has not yet come under control and the announced increase in the price of wheat will intensify pressures on food inflation for urban consumers. Federal share of taxes from the divisible pool will be further reduced to 42.5 percent while the inflexible expenditures by the federal government will continue to rise. There is hardly any indication that energy shortages that are hurting the business particularly manufacturing would be eased in the coming year. The circular debt stock could be rescheduled, but unless the gap between the unit cost of generation and unit sale price recovered is not filled on a non-recurring basis this problem will keep bouncing back. The deteriorating financial conditions of electricity companies, Railways, PIA, Steel Mills would again require substantial infusion of cash from the budget, while fiscal deficit is already in the danger zone. Their annual losses and financial charges cost about Rs360 billion. Any further induction of employees in these or other organisations will be a disaster for their financial health. The Debt-GDP ratio has exceeded the limits allowed by the Fiscal Responsibility Act. According to the UNDP Human Development Report 2011, Pakistan has fallen from medium human development category to low human development category because we are not doing enough in the fields of education and health.

Under the above external and domestic conditions any populist measures, for example creating new jobs in the federal ministries, departments, autonomous bodies, corporations to accommodate the nominees of the MPAs and MNAs, not passing on the price increases to consumers, diverting scarce development expenditure resources from critical investments in energy and infrastructure or other spending sprees, exempting some sectors or activities from paying taxes due on them would result in widening fiscal deficits. As external resources for the budgetary support are unlikely to be available, recourse to bank borrowing or worse to the central bank would become inevitable. The high-powered money would thus fuel inflation, putting pressures on the exchange rate. In Pakistan, a stable and predictable exchange rate has been a source of maintaining business confidence. If the exchange rate comes under pressure, speculators would move in and the foreign exchange reserves would begin depleting. The possibility of the currency crisis turning into a balance of payment crisis cannot be ruled out as the recent developments in India suggest.

India, a much healthy and stronger economy, has witnessed 16 percent decline in the value of its currency in the last four months. The large current account and fiscal deficits accompanied by drop in foreign capital inflows needed to finance shortfalls on the current account are the main factors behind the rupee's decline. The limited intervention by the Reserve Bank of India has led so far to a depletion of $16 billion in a month. A weak rupee in turn is also fuelling domestic inflation. If the government is not careful, Pakistan can see a rerun of events of the months ahead of November 2008 when the country had no other option but to approach the IMF for a standby loan arrangement to avoid a balance of payment crisis.

Politically it will be highly damaging for the incumbent party to face such an economic scenario just only a few months before the elections. The opposition parties will certainly use this situation to their advantage and a disgruntled population faced with inflation, unemployment, energy shortages, stagnant growth would be hard pressed to vote in favor of the incumbents. A few thousand party supporters, who got jobs and other favours would be in no position to neutralise the onslaught of the majority.

Contrary to what political advisers may be telling him, the prime minister and the party leadership should listen to what the economic managers are advising. The temptation for winning over the MPAs by increasing public expenditure and make-shift jobs should be resisted as the damage it will do to the standing of the government as a whole will be substantial. We should learn the lesson from the episode of 2007. The ruling party was quite confident at that time that a policy of appeasement and populism would guarantee them a victory at the general elections. This hope proved to be false while the resulting macroeconomic instability put the economy on a downward spiral. It is not advisable to tread on the same path because by now we know that it is highly treacherous and slippery.

The writer is Dean and Director, Institute of

Business Administration and former governor

State Bank of Pakistan.