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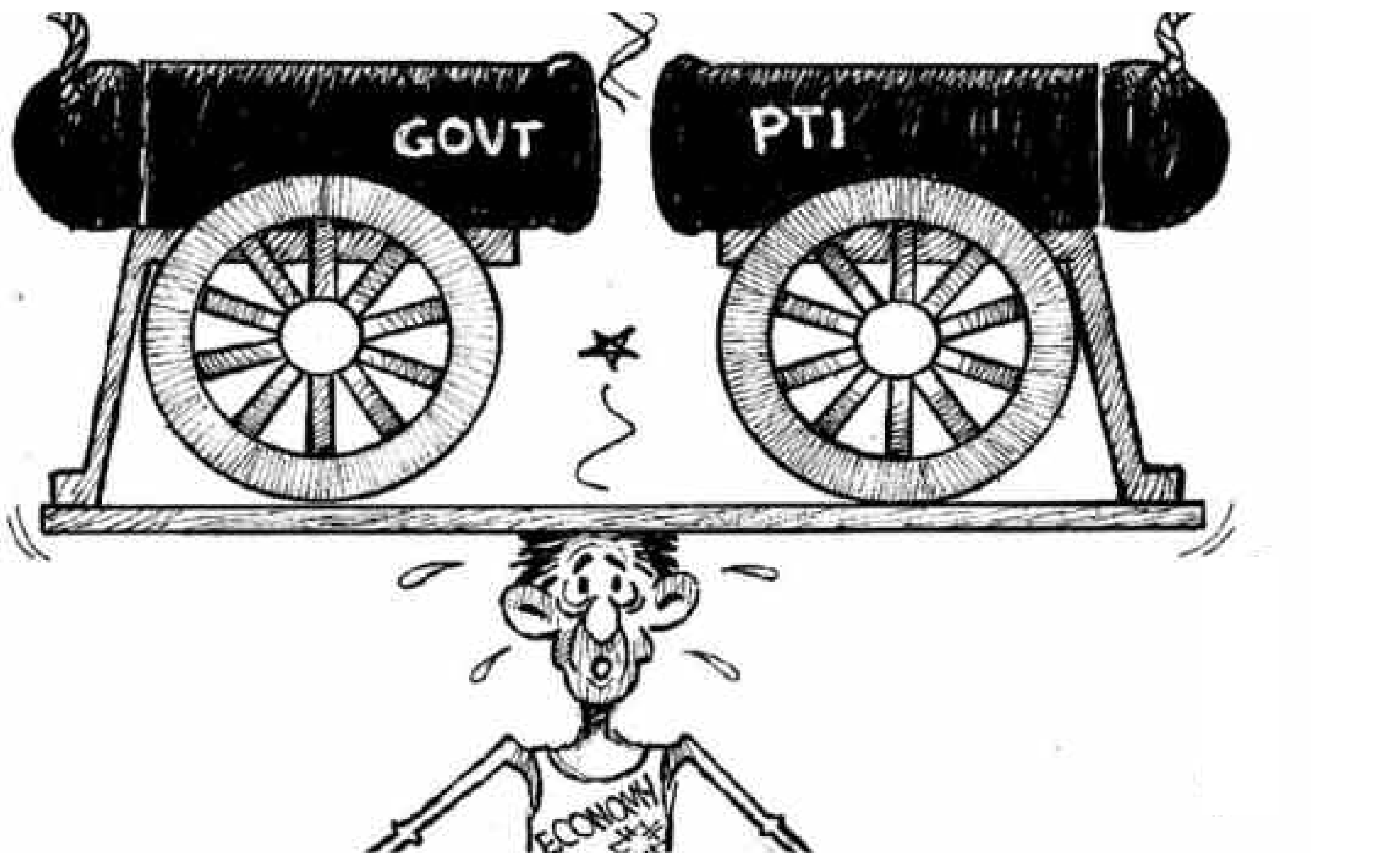

Interest rate increase

The Monetary Policy Committee (MPC) announced raising of the rate by 150 basis points to 13.75 percent, "assumes continued engagement with the IMF, as well as reversal of fuel and electricity subsidies together with normalization of petroleum development levy and GST taxes on fuel during Fiscal Year 2023." The withdrawal of the February 28 relief package would, the Statement correctly argues, raise inflation "temporarily and may remain elevated throughout next fiscal year" but as constantly pointed out by some analysts "thereafter it is expected to fall to the 5-7 percent target range by the end of FY24, driven by fiscal consolidation, moderating growth, normalisation of global commodity prices and beneficial base effects." One beneficial base effect is a lower budget deficit that by itself is anti-inflationary. However, this 'temporary' period can be reduced by policy decisions taken by the Finance Ministry, including a massive reduction in current expenditure, that would require major sacrifices from all recipients, and less focus on raising revenue from indirect taxes whose incidence on the poor is greater than on the rich and more on widening the tax-net. As noted in the Statement "the MPC emphasised the urgency of strong and equitable fiscal consolidation to complement today's monetary tightening actions.

This would help alleviate pressures on inflation, market rates and the external account. Four further observations are in order. First, while this decision was expected given the statement by Finance Minister Miftah Ismail before his departure for Doha to attend the policy level meetings with the IMF — tactless at best given the passage of the State Bank of Pakistan (SBP) autonomy bill, an IMF sixth review prior condition, and thoughtless at worst as statements by a Finance Minister do have implications on market perceptions — yet the rate rise to 13.75 percent is fully supported as the trade deficit surpassed 39.4 billion dollars during the first 10 months of the current year against 31.8 billion dollars during fiscal year 2018-19 and $37 billion in 2017-18.

Finally, the headline inflation rose from 12.7 percent in March to 13.4 percent in April driven by perishable food items and core inflation. Food and non-food component of CPI rose by 5.07 percent Urban and 7.7 percent Rural with non-perishable food items rising by a lot higher than the perishable food items due to not only the eroding rupee but also the rise in commodity prices globally as a consequence of the ongoing Russian-Ukraine war. As a result, excessive pressure on the rupee should attenuate and SBP's FX reserves should resume their previous upwards trajectory during the course of next fiscal year."

A programme for economic prosperity

ARTHUR B LAFFER

The answer to Pakistan's dilemma must rely almost exclusively on the intrinsic resources and the people of Pakistan. The government needs to get out of the way — cut spending, rationalise taxes, deregulate the economy, reduce trade barriers, privatise state-owned enterprises, and establish a sound money.

The government should then be in the business of "undoing things" not "doing things." The government has become the problem, not the solution. Pakistan is suffocating. Free markets are most needed when a country is in crisis. And yet, crisis almost always elicits massive government intervention. Free markets activate a country's economic immune system which is so desperately needed to get out of the crisis.

Unreasonably high tax rates, quixotic tax enforcement, corrupt implementation of rules and regulations, and self-serving trade interventions incentivize expensive tax-sheltering policies and counter-productive behavior for individuals and businesses.

The solution What's missing in Pakistan is a simple, straight-forward set of supply-side economic policies. Pakistan needs:

i. A total rationalization of its tax system from A to Z. There should be few taxes, where those taxes that are chosen to remain have low tax rates on broad tax bases. Exemptions, deductions, exclusions, credits, and write offs should be kept to a bare minimum. Low tax rates provide the least incentive for people and businesses to evade, avoid, or otherwise not report taxable income.

A broad tax base removes as many ways as possible for people to hide their income to avoid paying taxes. With enough love for one's country and an abundance of political will, such a tax reform is relatively easy to achieve. But the relatively effortless implementation shouldn't fool you. It will have massive beneficial consequences.

ii. A major repositioning of companies and businesses that are owned and operated by the government. This group may also include businesses that are so heavily regulated that they effectively are owned by the government—for example, privately operated public utilities.

A comprehensive plan for wholesale privatization of these businesses needs to be developed and implemented as soon as possible. The revenues from the privatization sales will go a long way to help Pakistan's fiscal quandary, but even more so the removal of these businesses from Pakistan's ownership ledgers removes a huge net drain on Pakistan's fiscal solvency as well as on the limited high-talent personnel who have been diverted from proper government needs to oversee the operations of these state-owned entities. This proposal to privatize too will have a life-changing impact on Pakistan's prospects for prosperity.

iii. Much freer trade than it currently has. The revenues from tariffs and fees on imports, exports, and other cross-border transactions pale in comparison to the economic dislocations those trade impediments engender and the culture of corruption that results.

The absolute pandemonium created by border-control bureaucracies disrupts what could be enormous gains from trade for the Pakistani economy. There are production gains from trade, consumption gains from trade, and dynamic economic growth gains from trade—each of which has been short-changed due to officially sanctioned border bureaucracies including domestic export subsidies, import taxes, and burdensome regulations. Free trade for Pakistan would by itself add enormously to the country's prosperity. Again, this type of reform could be implemented fairly quickly and would start yielding returns almost immediately.

iv. Sound money! I can think of nothing that has a more pervasive, insidious impact on prosperity than Pakistan's unstable, weak currency. People and businesses rely on the Pakistani rupee for any number of transactions, both for present market transactions and future contracts.

Without a widely accepted stable numéraire, markets as we know them dissolve, and wildly inefficient barter ensues. The rupee's volatility and depreciation, as shown in any number of indicators, indices, and measures, is a direct assault on market efficiency and economic progress. The effect inflation has on business, households, and government budgets is extraordinarily impactful and damaging. How can anyone plan when no one knows the future values of the currency? They can't.

V. A government budgetary process that doesn't always lead to excessive spending.

Spending other people's money rarely leads to financial parsimony, economic efficiency, or economic growth. Excessive government spending, however, does lead to underperformance at federal and local levels. Insider dealings replace markets and corruption undermines trust in government. Both political and personal goals are enhanced by the power of the purse. As such, there are substantial incentives for the political budgetary process to lead to excess spending. This is especially true when "buying" votes and dispensing of personal favors are in play. I know of no simple answer to the over-spending issue, save for direct irrevocable spending limits placed on government. Pakistan government spending is way too large and needs to be brought down to a manageable size.

As Prime Minister Margaret Thatcher is reported to have said, "Government will run out of money long before politicians run out of great ideas to fund." As is the case with families, government needs to adhere to strict budget limits. Also as with families' spending programs, there needs to be a specific date when each government program automatically ends. Well-designed budgeting will produce ever-increasing benefits throughout the entire fabric of Pakistan's society. This is where enlightened leadership plays its most important role. Pakistan has that leadership. And lastly —

vi. A thorough review of regulations, restrictions, requirements, and directives to make sure each one is justified on a strict cost/benefit basis.

Rules need to be framed to rationalize and coordinate public behaviour. People can't be allowed to choose which side of the road they drive on. That's obvious. But the danger here is that these rules and regulations individually and collectively will extend way beyond their specific task at hand and result in excessive collateral damage to the economy. We all know of any number of examples where policies and rules adopted with the best of intentions actually cause enormous damage.

Once put in place, government regulations are next to impossible to remove. An ounce of prevention here really is worth a pound of cure. Regulations, rules, restrictions, and requirements should be carefully and objectively reviewed and evaluated on a continuous basis to ensure economic efficiency as well as social cohesion. Sunset provisions here, as with government spending programs, need to be precisely defined ex-ante.

The question of neutrality

SYED SHEHERYAR RAZA ZAIDI

Never has the English language assumed such significance in Pakistani politics as it has now. Three words lie at the heart of the current political dispensation: 'neutrality', 'conspiracy', and 'interference'. Ironically, if the PTI and its leaders are to be believed, the era of 'neutrality' is what began the untimely slide that spelt the end of their regime, and the words 'interference' and 'conspiracy' were just the means to an end.

Of late, former prime minister Imran Khan and his party have trained their guns on the 'neutrals' and how they stood by as the regime was ousted through a 'conspiracy'. This is part of an apparently concerted campaign of thinly veiled jibes aimed squarely at the neutrality of the knights — i.e. the military establishment. While the PTI continues to call 'neutrality' into question, the current government, i.e. the establishment's former detractors, continue to hail 'neutrality'. All this begs the question: just what role (if any) do the knights have to play in such times of polarisation? The Constitution of Pakistan, which seems to be the flavour of the day, may hold the answer.

Chapter 2 of Part XII of the Constitution, titled 'Armed Forces', deals with the responsibilities of the military and its command. Article 244, read with the Third Schedule to the Constitution, provides the 'oath' that members of the military swear to abide by. This 'oath', often alluded to in political debates around the country, and with good reason, clearly prohibits members of the armed forces from engaging in political activities. This is what 'neutrality' entails — staying clear of political quarrels, controversies and mudslinging, and letting the politicians create and mop up their own mess.

To this end, it appears that the knights have made a conscious decision to stay away from the 'dirt' of politics. This attempt at 'neutrality' was visible when the DG ISPR, on being asked about the demand for early polls, referred the matter wholly to the 'politicians'. Conversely, sympathisers of the PTI argue that such 'neutrality', ie the need to stay out of politics, should not be seen in a vacuum. The armed forces, much like all other state institutions, have a role to play in safeguarding the interests of Pakistan. In continuing with their rhetoric of 'conspiracy' and 'interference', they refer to Article 245 of the Constitution, which primarily lays out two broad functions of the military. The first is to defend Pakistan against external aggression or threat of war, and the second is to act in aid of civil power when called upon to do so. Interestingly, both functions are to be taken up under the directions of the federal government, ie the federal cabinet including the prime minister.

They argue that the blatant 'interference' in the affairs of Pakistan, as confirmed by the National Security Committee (NSC), presented an external aggression, which all state institutions including the armed forces were duty-bound to foil and act against. This 'interference', they believe, was to topple the regime led by Imran Khan, something which did eventually transpire when Imran Khan became the first prime minister in history to be ousted through a no-confidence vote. It is this inaction of the military being 'neutrals' which the PTI laments. Interestingly enough, the NSC, under the premiership of Imran Khan and now under Prime Minister Shehbaz Sharif, has refused to term this 'interference' a 'conspiracy'. In the context of 'neutrality', this has far-reaching repercussions. To the military establishment, the current government and a number of former Foreign Office personnel, the undiplomatic conduct of a US state official was nothing but that. There existed no deliberate scheming by foreign powers with or without the help of local handlers — ie, no 'conspiracy' to oust the PTI government.

What, then, does the word 'interference' signify? And would such 'interference' merit a break with neutrality? The answer may lie in the various press releases and press briefings of the Foreign Office of Pakistan over the years.

One such example cited is the statement by the Foreign Office on Feb 15, 2018, when then president of Afghanistan, Ashraf Ghani, was accused of "interference in the internal affairs of Pakistan" because of his tweets in support of the Pashtun Tahaffuz Movement. At a more global level, when the then British foreign secretary Dominic Raab spoke in parliament against the passing of a new security law for Hong Kong in June 2020, the Chinese foreign ministry spokesperson condemned the UK's "blatant interference" in China's internal affairs. A bird's-eye view of diplomatic press releases around the world makes clear that the word 'interference', despite appearing to be one of immense value, in effect is a word used rather sparingly to condemn 'uncalled for' uses of undiplomatic language, and nothing but that. This, then, perhaps explains why, despite the continued and ferocious clamour for their support, the knights have opted to remain 'neutral' — ie, apolitical — even if it meant that a government was sent packing, because to them this no-confidence was nothing more than legitimate political activity.

On the flip side, however, unlike the above examples, the classification of 'interference' was done not by the Foreign Office but by a high-powered NSC. This lends credence to the gravity of the accusations being levelled by Imran Khan, who continues to enjoy mass support. The last thing that should be done is for these accusations to be swept under the carpet. The accusations should be thoroughly investigated by a high-powered judicial commission. Anything less than that would turn these accusations into an undeniable perception, which would ultimately call into question the legitimacy of the democratic process.

All said and done, whether the PTI is true in its narrative or not, one hopes that this 'neutrality' continues, not just because it would honour the dictates of the Constitution, but also because it would allow the existing political system to flourish, al-

Circling the drain

SHAHAB JAFRY

The Federation of Pakistan Chambers of Commerce and Industry (FPCCI) couldn't be serious that the "business, industrial and trade community is shocked" at the way the State Bank of Pakistan (SBP) raised the benchmark interest rate, by 150 basis points (bps) to 13.75 percent, in the last Monetary Policy Committee (MPC) meeting. You could say that the Bank surprised just a little to the upside because informal consensus did revolve around 100bps, but to expect a cut in this environment makes no sense at all and, if that is really what they were hoping for, also reflects very poor planning on the part of businesses.

And if they only looked out the window, they'd see that what's happening is very likely to produce so much volatility so soon that even the government's best efforts to prop up the economy would be highly inflationary because it would have to spend out of its own pocket and do irreparable damage to the current account. To expect it to cut rates to help businesses at the risk of stoking demand and raising prices even further would throw the economy into a tailspin; something like what's happening in Turkey. So it's a very safe bet that SBP's going to stay plenty hawkish for the foreseeable future, at least.

Yet it's not as if the Chamber made no valid points at all. Because not very much of Pakistan's inflation is demand-driven. Almost all of it has to do with unacceptable and unbearable levels of political as well as economic uncertainty, not to mention all the supply-side issues that have dogged policymakers since well before the pandemic. In fact, exogenous factors like the commodity super cycle, especially wheat and oil price inflation, are also really only inflating the cost-push type of inflation. How long, then, are we going to use interest rates to fight this price rise? A tanking economy, without even the life support of the Fund programme at the moment, and ridiculously high prices that are not responding to conventional monetary tightening will allow you to go with compromised industrial production and export for only so long.

FPCCI is also right that making formal money so expensive for businesses will make a lot of them look elsewhere, given the choice between going belly up and seeking refuge in the informal economy, and raise completely unnecessary red flags at the Financial Action Task Force (FATF). As for the Chamber's lament that monetary policy was out of sync with fiscal policy, it's not going to be too long before that's not technically correct. The International Monetary Fund (IMF) has made it very clear that the Extended Fund Facility (EFF) would only resume under the original conditions agreed with the Imran Khan administration. And since we cannot survive too long without it, that simply means that the time has come for fuel and power subsidies to go out the window; triggering another round of inflation.

Surely, all chambers and all businesses know that the government can do nothing for them at this moment. It's only a small blessing that the Saudis are working on extending the oil and loan facility and the Chinese are also expected to roll over another one of their bulky loans, because the state bank is hemorrhaging reserves at a pace that if we're not back on the right side of the international lending regime very soon, we will for sure be seeing the word default very often in the headlines.

It's also true that industry cannot be upgraded when it is already under-performing. That means there'll not only very likely be loss of production and export revenue, but the long process of revamping industry and adding value to exports will also have to wait till the economy gets better. But the economy's not getting better. Unable to grow, tax or earn enough to survive on its own, it is desperately dependent on fresh debt just to stay above water. Only now it's getting more and more difficult to get more debt and since the things we have to do to get it is beginning to hurt industries that get us the little export we can get, it wouldn't be wrong to say that the economy is circling the drain; and businesses, naturally, with it.