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Band-aid *Permanent*
National Debt: ~~Political Gimmicks~~ or ~~Fundamental~~ Solutions?

There is a national consensus today that our national debt should be sharply reduced, or even wiped off altogether, since it is compromising all our attempts to balance the budget, to revive the economy, and to contain inflation. The responsive chord that Prime Minister Nawaz Sharif's call to repay national debts has struck among the masses only proves that the consensus on this issue is widespread by now, not confined to the musings of economic technocrats or prescriptions of international agencies.

But there seems to be no consensus yet on the solutions. In fact, there is a search for easy gimmicks or populist slogans, without the nation being educated about the tough decisions that lie ahead.

The call to expatriate Pakistanis and masses at home to help repay national debts is a bold political stroke so long it is kept in perspective. Its net impact on repayment of debts is likely to be marginal. The best-informed estimates are a net inflow of \$ 300 to 500 million, though this may prove to be quite optimistic since most of the contributions so far are a mere transfer from existing low-interest bearing foreign currency deposits to new higher-interest debt repayment accounts. Even this is fine since it changes the maturity structure of foreign currency deposits and creates some stability that these deposits will be kept in the country for 2 to 5 years and not withdrawn abruptly. But here lies the rub: the total net inflows may not amount to even 0.5 per cent of the total national debt. This may give us a brief breathing space but this is certainly no solution to the underlying problem.

What is the size of our national debt and which debts should be repaid immediately? The total debt is now around \$ 63 billion, of which \$ 40 billion is foreign debt (\$ 30 billion external loans and \$ 10 billion foreign currency deposits which can be withdrawn any time) and \$ 23 billion in expensive domestic debts. Not all this debt is on onerous terms. In fact, most of the \$ 30 billion of external loans from bilateral donors and international agencies are on extremely

concessional terms – average of 4 per cent interest rate and 25 years repayment period. While we should become self-reliant enough one day to be free from even these concessional loans, this is the last item we need to worry about at present. Most worrisome is about \$ 3 billion of short-term foreign bank loans at extremely high interest rates whose repayment schedule every few months causes the finance ministers a nervous break down. Moreover, while \$ 7 billion out of \$ 10 billion of foreign currency deposits may be more stable – linked as they are to the family support of expatriate Pakistanis or used as they are as collateral for rupee loans – at least \$ 3 billion are in the nature of “hot money”, ready and able to jump across borders at the push of foreign computer keys at the slightest whiff of impending national bankruptcy, or gross economic mismanagement, or political instability in Pakistan, or rising interest rates abroad. Our external viability hangs by a thread. Several reputed international investment firms have already speculated in recent months that there is a 90 per cent chance of Pakistan defaulting on its debts during 1997 – a prediction that we must all prove wrong for the solvency of our economy.

Let us also remember that our budgetary problem is linked more with our domestic debts, not with external debts. Pakistan's domestic debts now exceed Rs.900 billion and carry interest rates of 12-18 per cent. What are erroneously and somewhat deceptively called National Savings Schemes in each budget are nothing but borrowing schemes and a part of the ever-growing national debt. The annual servicing of national debt is now costing over Rs.130 billion (over 5 per cent of GNP) and is likely to keep on increasing dramatically. If we cannot take some bold measures to wipe off this high-cost domestic debt, it is likely to wipe off all our budgetary options. In fact, it is already doing so since debt servicing and defence expenditures now exceed total budgetary resources, obliging us to borrow at 17-20 per cent interest even to pay for government salaries and day-to-day administrative expenditures, let alone all development expenditures.

In this overall context, “qarz-utaro” scheme must be seen only as a temporary relief, not a fundamental solution. What then are the basic solutions? There are at least three but each one requires tough political decisions.

First of all, we must be clear that any bold attempt to retire national debt will require a good deal of pain, a great deal of sacrifice, and national mood must be gradually prepared for it. The only option is whether to inflict this pain on the rich and the influential in the future (since they have borne so little of it in the past) or to continue to impose it on the poor, on the downtrodden, on those angry masses who are already in open revolt against past injustices. It is my firm conviction that there is no alternative left now but to put the burden of sacrifice on the rich --- the non-tax paying landlords, the tax-evading elites, the big loan defaulters, the corrupt and the politically immune. This is not going to be easy since this very class is close to the levers of power. The real question is whether Prime Minister Nawaz Sharif, with his unprecedented national mandate, can persuade this influential group to make its due contribution to the retirement of national debt and the balancing of the budget. When taxi drivers, clerks, peons, widows, and many ordinary citizens are displaying tremendous sense of patriotism and contributing their meagre savings at the call of the Prime Minister, what about the rich fat cats whose silence has been deafening so far?

The potential to raise money from this rich rentier class is enormous. Just a few illustrations. The untaxed agricultural income exceeds Rs.600 billion today. Even an average tax of 10 per cent can yield an annual revenue of Rs.60 billion, or nearly 3 per cent of GNP. The estimated tax evasion from non-agricultural incomes exceeds Rs.100 billion a year, over 4 per cent of GNP. The stuck-up loans in nationalized banks and DFIs are estimated at Rs.140 billion, or nearly 6 per cent of GNP. No one knows the extent of corruption in our society though some recent estimates have put it anywhere between 5 per cent to 10 per cent of GNP. In view of over 20 per cent of GNP which escapes the public net in such blatant defiance, it sounds so tragic that the entire nation goes through such a trauma to meet the IMF conditionally of lowering the budget deficit by only 2 per cent of GNP. Easy options are found to raise utility prices or indirect taxes on the masses rather than to tax the rich and the powerful. Before we raise a national outcry at external interference, should we not examine our own fiscal indiscipline? And are the poor masses not entitled today to ask why the rich are not being obliged to contribute to resolving the national crisis, when this class has benefited so much in the past? The national debt problem is not going to be resolved by collecting Rs.10-20 billion from the poor though enthusiastic masses ----

if they contribute even that much. The real money is with the rich and they must be made to pay their share.

Second, there is an opportunity today to swap our domestic debts against our public assets and to rid the budget of ever-increasing interest payments. While our domestic debts exceed Rs. 900 billion, so do our public assets in the form of telecommunications, power stations, gas companies, airlines, industries, banks, DFIs etc. When we are in such a tight budgetary corner, why not sell those public assets to wipe off the domestic debt?

If we are prepared for such a debt-equity swap, the best thing to do is to set up a consortium of the most reputed international investment underwriters – for example, Morgan Stanley, Goldman Sachs, Solomon Brothers, Bear Sterns, Merrill Lynch, Morgan Grenfell, and the like. These firms have international credibility and considerable experience in privatizing the assets of many emerging economies. They should be given a 2 to 3 year period to prepare the ground for marketing Pakistan's public assets. Their advice should be listened to carefully in restructuring our public concerns before their eventual sale. The best course is to sell these assets openly and transparently in the form of shares in international stock markets, normally against payment in foreign exchange, so that we can raise a cushion of over \$ 20 to 25 billion over the next two to three years.

Some analysts shudder at this prospect. Why sell the "family silver", they argue. They answer is a simple one. No one is transferring these public assets outside the country. They will still be serving the people of Pakistan – perhaps a great deal more efficiently if private sector can run banks, telephones, power stations, airlines, industries and other services much better than the public sector. There will probably be less corruption and more market competition. And by releasing budgetary resources from the burden of ever-increasing interest payments and by investing substantial sums in human capital, we shall be exchanging the "family silver" for "family gold", since we shall be preparing a new generation of Pakistanis for the global competition of the 21st century. Government has no business to be in business: it should be in education, health, nutrition and other social services.

There is some anxiety that if public utilities (like, gas, electricity and telephones) are transferred into private hands, charges of these services may be raised with impunity. This is certainly a legitimate concern. Like many other countries, we shall have to set up National Regulatory Authorities so that any adjustment in rates is publicly discussed in the parliament and charges for utilities are increased only after making a through examination of all the related issues and reaching a national consensus. This will be a more transparent process than the current practice of raising utility prices arbitrarily and often to meet budgetary shortfalls, without any public debate whatsoever and without any analysis of their wider economic implications.

There is another concern which is less valid though more prevalent. It is suggested that a major part of our public assets will be purchased by foreign investors, since domestic savings are limited and local investors can pick up only a fraction of Rs.900 billion worth of assets. For foreign investment, however, \$ 23 billion is a tiny sum at a time when \$ 1300 billion roam around the globe every 24 hours in search of attractive investment opportunities. Some hysterical commentators go as far as invoking the image of "a second coming of the East India Company".

Many of these critics have slept through the last few centuries, like Rip Van Winkle. The world has changed dramatically since the days of the East India Company when foreign governments came in the guise of private companies, with foreign soldiers and a foreign flag, and colonized hapless nations. Today, it is computers which buy foreign assets through international mutual funds invested in emerging markets. These portfolio investments respect no political ideology and no geography: they follow the simple dictates of profitability. We can only gain by foreign capital working as our slave, not as our master. We can also take two additional precautions. Assets can be sold in the form of small shares so that their ownership is diversified all over the world. Furthermore, a certain portion of the shares can be reserved for domestic investors or for government's representation on the boards of management. Those who are still nervous about foreign domination should ask one of the most nationalist leaders in the Third World, Mohammad Mohatir of Malaysia, why he has sold most of public assets of Malaysia to foreign investors.

It is time that we design a grand deal for a debt-equity swap and ensure that all our domestic debts are wiped off over the next few years so that we enter the 21st century with a clean national slate. Any such strategy should be woven around the following six elements:

First, international and domestic markets should be prepared carefully for the sale of public assets by hiring some professional international investment firms. If some assets are not ready for sale (like nationalized banks, where considerable loan repayments are stuck), it is the responsibility of the government to first remove the difficulty (e.g. by a vigorous drive to collect stuck-up loans), rather than sell these assets for peanuts. Distress sale at basement prices is not in national interest.

Second, a public asset should be sold in its entirety, not just a small portion of it. It makes no sense to sell an asset in small dribbles: those private investors who wish to purchase it want to make sure where the ownership rests and whether the asset will be run more efficiently in future. A reluctant, hesitant sale strategy is generally a recipe for disaster. A small portion, not exceeding 20 per cent, can always be reserved for government's representation on the management boards.

Third, it is far better to convert the public asset into small shares, to be sold openly through domestic and international stock markets, than to negotiate with individual investors/multinationals. Such a strategy ensures diversified ownership, and is generally more transparent and free from allegations of corruption or patronage. Test of the market is far better than government negotiations, even if brilliant and honest.

Fourth, the most expensive and the most volatile short term debts should be retired first. This category includes short term bank loans, more volatile foreign currency deposits, and high-cost domestic debt.

Fifth, every penny received from the sale of public assets must be used for retirement of the stock of national debt – certainly not for current expenditure or even for debt servicing. A National Debt Retirement Fund should be created by an act of parliament and it should be ensured that all receipts are credited to such a fund. Our recent experience is not too reassuring. Most of

the sales proceeds from public assets were consumed by the ever-persistent demands of budgetary expenditure. The worst scenario will be if we pass on all the debts to the next generation without even passing on any assets.

Sixth, the revenues released from interest payments should be used both to provide essential social services to our people and to eliminate the budget deficit. In fact, wiping off domestic debts can release 6 per cent of GNP in public savings. This is enough to reduce the budget deficit by half and yet double the expenditure on education and health.

The third part of the strategy to retire national debts goes far beyond balancing financial accounts to balancing the real accounts of the nation. No country can achieve a permanent solution of its debt problem unless its economy is made vigorous and strong. Ours is quite weak and anemic at present. Gone are the days when we took 6-7 per cent growth rate in GNP for granted and when industrial growth was a hefty 12 per cent a year. We are lucky these days if economic growth stays ahead of population growth and if we manage to avoid a stagnation or even a decline in our per capita incomes and production.

There is a brave talk of converting Pakistan into an East Asia tiger soon. But industrial tigers are bred after generations of education, land reforms, high savings, skills and technology, and disciplined hard work: they do not spring up overnight through political slogans. Pakistan has a literacy rate one-third of South Korea; its spending on education is one-sixteenth as much as Korea's; only 1.6 per cent of Pakistan's secondary school children go for technical education compared to 25 per cent in Korea; and investment in science and technology in Pakistan is not even a small fraction of what it is in Korea. Yet we dream of becoming a Korea, or better, without wanting to follow the long, disciplined path that was followed by the East Asian tigers. No uneducated, feudal society has yet become a tiger of any colour or form, though there is nothing stopping us from making such a novel experiment. Pakistan is today at least 25 years away from becoming an industrial tiger even if it takes all the tough decisions which are necessary. We should today focus on a major investment in education, science and technology, skill information and export-led industrialization. Without these steps, any talk of becoming an East Asian tiger will always remain empty rhetoric.

It is true that we must increase our exports dramatically if we are ever to earn viability in our external accounts. But it is no use brandishing export targets of 20-30 per cent periodically without even doing the basic home work. Let us face it. The global market for our present exports of cotton, rice, textiles, leather goods and carpets is expanding by no more than 1 per cent a year. How do we obtain a 30 per cent expansion in exports in such a stagnant global market for our structure of exports? The answer lies in a fundamental restructuring of our production and exports by focusing on computer softwares, electronics and low-tech consumers goods --- much the same strategy that East Asia and China adopted and which India is trying to copy in its own "silicon valley" in Bangalore --- since global markets are expanding by over 30 per cent a year for such products and since trade restrictions are very low on these items in the western world. But if we are to change the structure of our exports fundamentally, it requires long-term development planning, rather than slashing of all development expenditure (particularly education and science) each time we face a stringent budgetary situation.

The main point is this: while debt repayment is a laudable objective, its real solution requires some far-reaching decisions. It is a tough and a hard road to travel. As a nation, we have not even begun the journey.

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