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Strategic pullback

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‘Budget season’ is a good time for a critical reflection on Pakistan’s current economic challenges and future prospects. Our fiscal budget is constrained by broader political and economic forces, both national and international – for instance, the regulatory regime of international financial institutions (IFIs), the extent of polarization in the country, and the state of governance etc. Therefore, the foremost priority during this ‘season’ should be to reflect on how to expand the fiscal space, given all these parameters.

Currently, our spending is disproportionately skewed towards debt servicing and defence expenditure; this is despite the fact that the latter has remained stagnant in the last three years while India has seen a 62 percent increase in its defence budget. Our development budget is shrinking. The long-term effects of these trends on both economic security and growth should be of extreme concern, to say the least. Our ability to develop and defend ourselves is directly tied to the state of the economy.

In order to expand fiscal space, Pakistan’s economy has to consistently post robust growth rates for a sustained period. However, the government’s naive understanding rests on the premise that fiscal space can simply be increased by increasing the tax rate or expanding the tax net. While the latter has certainly more potential than the former, both are inherently myopic accounting approaches.

A key question that unfortunately tends to be ignored in the budget discussion is how to expand the size of the economic pie. We need to learn from the best global and regional case studies. Bangladesh and Vietnam have recently turned around their economic fate by prioritizing Foreign Direct Investment (FDI) and exports. It is important to note that FDI tends to precede growth in exports as the former brings innovation, technology, world class skills as well as integration with global supply chains. Pakistan attracted $1.5 billion in FDI while Vietnam attracted $28.5 billion in 2020.

Now a crucial question is how to increase FDI, not marginally but substantially?

Around $2 trillion floats annually around the globe in the shape of FDI looking for attractive destinations. The question is: what are the underlying dynamics – the macro and micro factors that attract FDI in any country – and where do we stand against those?

At the macro level, based on my experience in government, there are two critical factors that have impeded growth of FDI in Pakistan: 1) the political environment; and 2) the institutional landscape, specifically the legal system. At the micro level, efficiency-related issues such as red tape and inadequate infrastructure capacity are important.

Political stability and sustainability of policy frameworks are important for investment but they have been missing in Pakistan. Political instability and uncertainty created by continual unconstitutional interferences has been a major red flag. Every ten years, a debate is started on whether Pakistan is more suited to a presidential system or a parliamentary system. Further, politics in Pakistan has not been evaluated on the basis of socio-economic development, performance and delivery for the people – rather it hinges on having the 'right kind of alignment' with power-wielders and stakeholders including the establishment.

The second important factor that determines FDI is investor confidence in the strength and credibility of the host country's institutional landscape, particularly the legal-judicial system. This leads one to wonder: why would any global investor take the risk of investing in a country where allegations of manipulation of the judicial process for political victimization are routine news on the national media? Even CEOs of local and global private firms have been dragged into political witch-hunts.

The instrumental question is whether the institutional arrangement of a country is pro-development or not. The fundamental requirement of having a pro-development institutional arrangement is the following: the de facto should reflect the de jure distribution of power.

FDI is not contingent on whether a country is democratic or non-democratic, but on whether a country is predictable or not, whether the lines of authority are clear or blurred. The best way to assess predictability is to look at a country's constitution, rules of businesses, its legal system as well as whether these are effectively implemented or not. It does not matter how business friendly policies are on paper if there is a disconnect between the de jure and the de facto.

In Pakistan, de jure power rests with elected offices, while de facto power is primarily rooted in non-elected forces. The sharp divergence within them creates unnecessary and unavoidable discord and dichotomy. This situation is detrimental for the development of a healthy institutional ecosystem.

With a growing youth bulge, we can't survive with a mere $1-2 billon annual increase in exports and FDI. We need to figure out the fastest path to achieving $250 billion exports and $35 billion FDI from the present level of $25 billion and $1.5 billion. It is a doable task, provided we can make an investment pitch for Pakistan as a market of a 220 million population and a 60-70 million strong middle class that offers political stability, a strong legal system and a business-friendly environment.

Incrementalism and business-as-usual are a recipe for disaster; we urgently need a reset for a leapfrog jump and no single institution or government can undertake this task on its own. Only the state of Pakistan with the full support of all important stakeholders can put the country on the rapid path of economic development.

Nothing hurts a country's endeavors for economic growth and development more than institutional disharmony. The world has learned the hard way that for an economy to grow on a sustained basis, all institutions need to work within the ambits defined by the constitution. Civil and political institutions need support overtime; and internal conflict and mistrust are not compatible with economic growth and development.

In recent decades, there has been a realization in many countries with a similar predicament that political intervention by non-political spheres is a lose-lose equation, and so there has been a conscious effort at a pullback in order to create space for civil and political institutions to take ascendancy. Does that mean that here too there may be willingness to decide on a 'strategic pullback' to forge a new political consensus for the future of Pakistan?

There were 'strategic advances' in the past in the name of the national interest. Then why not a 'strategic pullback' in the national interest to enable Pakistan to find an equilibrium that allows the growth of strong political and legal institutions to plug the macro-level gaps that are impeding our progress and development on political and economic fronts?

For Pakistan to thrive economically, relevant stakeholders need to bridge the growing de jure and de facto split in our system: the parliament, elected government and judiciary should be empowered according to the spirit of the constitution. The establishment needs to see both as partners in building 'deep national power'. When the national power is dispersed across institutions and the civil society, the nation is more stable and secure.

There is also a big responsibility on the shoulders of the political leadership to, on the one hand, develop political parties as strong institutions with policymaking capacity and on the other hand, elevate the role and status of parliament through a bipartisan legislative agenda focusing on economic development issues.

The alternative is to keep doing what we have been doing so far and keep getting what we have been getting for the last 72 years. Destiny is in the choices we make.