

# ISAS Brief

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## Post-poll Pakistan's Economic Priorities<sup>1</sup>

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The Pakistani electorate has given Mian Nawaz Sharif a commanding lead in the newly-elected National Assembly and a clear majority in the Punjab provincial assembly. In South Asian politics, incumbency is rarely rewarded. The fact that the Pakistan People's Party suffered a humiliating defeat is in keeping with this trend. The party was punished for its poor economic performance and even more for its very poor governance. Under its care, Pakistan not only saw the economy move into a long-term growth recession. It also led to Pakistan being labelled as one of the most corrupt countries on earth.

But the anti-incumbency factor did not apply to the province of Punjab, where the government, led by the Pakistan Muslim League (Nawaz) [PML(N)] and Mr Sharif's brother, was given an even larger mandate. The electorate approved of what the party did for the province. The voters also recognised that, even though the federal government was not supportive of the provincial administration, the PML(N) ran the Punjab economy to their satisfaction. The rate of growth in the province was about the same as that of Pakistan. This was not surprising, since Punjab accounts for 60 per cent of the country's population and about the same proportion of the national GDP (Gross Domestic Product). That

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<sup>1</sup> This Brief is the second in a series of ISAS papers focused on Pakistan and its historic opportunity at this time.

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notwithstanding, the citizens in Punjab reckoned that the PML(N) administration cared for the people's welfare. The same could not be said for the PPP-led government in Islamabad.

The electorate accepted the claim of the likely third-term prime minister that Pakistan had sailed into a perfect storm as result of the poor handling of the economy by the PPP-led government in Islamabad. The voters bought this message and put the messenger back into the office he had occupied twice before. In the 1990s, Nawaz Sharif was twice elected as prime minister. In 1993 he and his administration were dismissed by President Ghulam Ishaq Khan for poorly managing the national economy. The then president could do that by using a provision inserted in the Constitution by his predecessor, President Zia-ul-Haq, the third military man to become the head of state. In 1999, Sharif was removed from office by the military after he made a clumsy attempt to fire the Chief of Army Staff, General Pervez Musharraf. Now, Mr Sharif returns to office, more secure about his job. The Constitution has been cleansed of the changes made by the military rulers. The president no longer has the constitutional authority to dismiss the prime minister and dissolve the national assembly. The military, aware that the Pakistani street and the assertive judiciary will not countenance another intervention in politics, is likely to stay away from the political stage.

Sharif is expected to move – and move quickly – in four areas: steer the economy out of the stormy waters in which it was left by the government headed by President Asif Ali Zardari; deal with the growing problem of domestic terrorism; continue with the development of the political order so that it gains the support of all regions and segments of society; and repair relations with the outside world. At this moment economics should be at the centre of public policy making. There is a strong relationship between political and economic development, a fact recognised belatedly by economists. A well-developed political system helps economic grow and provides for all segments of society. Sharif appears to have recognised this.

The first few moves he has made after winning the elections are aimed at introducing collaborative rather than contentious politics. On 13 May 2013, two days after scoring a decisive electoral victory, he called on Imran Khan who remained in hospital, recovering from the accident he had suffered a few days before the election. According to Salman Masood of *The New York Times*, “regardless of the final tally expected later this week, Mr. Khan’s Tehreek-e-Insaf party will become a significant player on the political scene, controlling the regional government of a major province. Considering the challenges ahead, Mr. Sharif buried the hatchet and brought flowers”. Addressing the press after a conversation with the Pakistan Tehreek-e-Insaf leader, Sharif said: “Today we have made peace. He [Imran Khan] was receptive and acknowledged my gesture”.<sup>3</sup>

The PTI will lead the provincial administration of the province of Khyber-Pakhtunkhwa and will be in a position to play a critical role in bringing peace to the province which is home to various Taliban groups, including the powerful Tehrik-e-Taliban Pakistan (TTP), which has carried out a number of operations in the country, most of them directed at the security

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<sup>3</sup> Salman Masood, “As Pakistan’s likely premier, Sharif offers truce and flowers”, *The Global Edition of the New York Times*, 16 May, 2013, p. 3.

establishment. The TTP also organised a bloody campaign to discourage voters from participating in the electoral process. It supports the Haqqani Group, which operates from sanctuaries in Pakistan's North Waziristan tribal agency and has been effective in stalling the American efforts to establish Kabul's control over the Afghan provinces bordering Pakistan.

The TTP and the Haqqanis could disrupt the process of America's withdrawal from Afghanistan. The United States is planning to pull out US\$ 60 billion worth of equipment in the next 18 months as it ceases its operations in Afghanistan. Having some kind of agreement with these extremist organisations is, therefore, critical for America's withdrawal and the future of Afghanistan. It will also help to bring security and stability to Pakistan which is necessary for any programme of economic revival.

The markets are expecting the prospective Sharif government to move quickly in improving the management of the economy. On the first trading day after the election, the KSE-100 index rose by a staggering 329 points, reaching a record of 20,245. On the following day, it added another 230 points to reach 20,475. The signal from the market was clear: it expected quick action from the likely new government, exuding confidence that the new policy makers would prove equal to the task. By choosing a person to lead the Ministry of Finance before making any other appointment to the cabinet, the prime-minister-to-be has indicated the importance he is attaching to economic affairs.

As the first priority, the new administration should aim to build the confidence of the community of investors, both domestic and foreign, in the country's economy. As economists have argued for long, confidence about the future is an important determinant of economic performance. Before the elections, investor-confidence had plummeted to the point that the share of national income that was ploughed back into the economy reached the lowest level in the past five decades. Little capital was being invested in Pakistan by foreign entities. In fact, some of the firms that had been present in the country for a long time began to unwind their operations and move out. Domestic investors had also lost faith in the economy's future. There was anecdotal evidence about capital flight from the country. Instead of risking their capital in domestic ventures, potential investors were prepared to accept much lower returns by placing their money abroad. The fact that the Pakistani rupee had been sinking in value, as against foreign currencies, also created an incentive for keeping savings outside the country.

Restoring investor's confidence, therefore, should be the new government's highest priority. This raises the obvious question: how should this be done? The first issue the new policy makers will have to address concerns the management of foreign reserves. Pakistan owes large amounts of money to the International Monetary Fund. There has been a steady decline in the reserves available to the country to pay for the difference between export earnings and import expenditures and to service foreign loans. The latter includes the scheduled payments to the Fund. One solution will be to return to the IMF and ask for it to finance a new programme aimed at stabilising the economy.

The programme will have to be supported with a flow of IMF money which is more than what is owed to the institution. It must also provide enough financial resources to keep the country solvent for at least a couple of years. This means a programme of the same size that was signed with the Fund in 2008. Would the IMF be prepared to do this, given Pakistan's past record? The country has signed on to many Fund programmes but completed only a few. Before entering into another programme, the Fund will ask for the implementation of what in its language are called "prior actions". These will undoubtedly include a significant reduction in the fiscal deficit, which in turn would require major changes in tax policy and the system of tax collection; withdrawal of many subsidies that put a large burden on the government's budget; reform of power tariffs; and reduction of the large deficits incurred by several state-owned enterprises. It is only after these actions have been taken, that the IMF staff will be able to take a new programme to its Board of Directors which will look at it with great scepticism.

Such a heavy dose of structural medicine may not be possible for a new administration to swallow as it settles to govern for the next few years. It would involve sacrifices by a number of entrenched groups which will not be prepared to withdraw from the economic space that was created for them by the previous government. Some deft political management will be needed, a process that has begun with the Sharif-Khan meeting. The new leaders are looking for bilateral financial support from some of the country's friends including China, Saudi Arabia and the United States. This would provide some breathing time before a more enduring programme of support can be put together. The approach would be to take a few months to develop a programme of its own before Islamabad returns to the Fund. This could happen by the end of the year.

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