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Why do we borrow?

Economic development is said to be about taking the difficult but necessary steps to achieve sustained growth. For example, increasing domestic savings is very difficult, but imperative, maintains Yao Yang in one of his articles (The open secret of development economics) published on October 22, 2019 in the Weekly Agenda of World Economic Forum.

According to the author, classical development economists saw that savings are essential for jump-starting economic growth in a poor country.

But in the 1970s, as savings from oil-rich countries and Japan flooded global financial markets, it was assumed that developing countries could simply rely on international borrowing to accumulate domestic capital. Many developing countries like Pakistan and others especially in Latin America tried to kick start their economies using borrowed resources but ended up trapped in an eternal debt trap.

However, China launched an effort to accumulate capital through domestic saving starting in the early 1950s. Despite being one of the world's poorest countries, China's national saving rate never fell below 20% of GDP before 1978. And after that, its national saving rate increased in most of the years leading up to 2008, reaching a peak of 52% of GDP in that year.

For a country to make full use of domestic savings, it must develop its own manufacturing capacity.

As Lee Kuan Yew, founding father of modern Singapore, famously observed: "No country has become a major economy without becoming an industrial power."

According to Yao Yang, China has done both. It began with labor-intensive exports, and gradually developed the most complete production network in the world; and it now ranks among the countries with the largest number of entrepreneurs globally.

"Practically speaking, economic coordination tends to require government action. When the four East Asian Tigers (Hong Kong, Singapore, South Korea, and Taiwan) attracted worldwide attention in the late 1980s, their rapid growth invited a lively debate about the proper role of government in economic development, giving rise to the notion of a 'developmental state.'

"Government intervention has proved most effective when it has mirrored that of other East Asian economies: helping with the accumulation of production capacity and providing coordination when needed.

"There is no secret to China's economic success. It has simply followed the advice of classical economists, taking the difficult steps that are necessary for progress over the long term. One doesn't

need an experiment to identify those steps; they are the same for all developing economies, and they have been known for decades."

Pakistan on its part seems to have failed on both counts: Its domestic savings rate has remained too low from day one and its manufacturing capacity as well has remained largely insignificant all along.

During his 11-year-long rule President-Field Marshal Ayub Khan did not let a legitimate tax culture to develop in the country as he had needed,for obvious reasons,the political support of the landed aristocracy and big business. Instead he deliberately allowed an anti-tax culture to develop by promoting what is called the licence-permit system. As a result, our domestic savings rate has since continued to remain on an average around 9-10 per cent of the GDP.

Friends and politically powerful families used to be obliged in those days with free distribution of licenses and permits. In many instances industries set up in the public sector by the PIDC would be sold to political favourites for peanuts. Banks were allowed to provide 70 % equity for 30% investment, mostly in textile and chemical industries. The sponsors used to over-invoice the imported machinery taking back in the process almost the entire 30% of their equity and also keeping the plunder in foreign banks. Next, after launching the unit they would under-invoice their exports making a killing which too would be kept in foreign banks. Money laundering, one could see, is not a new phenomenon; it was started way back during the Ayub regime.

Not only that. These made-by-PIDC 'industrialists' would float shares of their units on the stock exchange, say at the rate of Rs. 10 per share; then they would manipulate the market to depress the share price to half of the original and buy them back all and keep them, almost 99% in the family. And since they were not entrepreneurs but businessmen created out of license and permit system they would not spread their business risks by investing in more than one enterprise and also would not reinvest in upgrading their enterprises with new machinery and innovation. And they would, instead of producing quality goods achieving economy of scale would instead pilfer utilities like water, electricity and gas, besides taxes due to them to keep increasing their margins.

Since tax collection was not a priority in those days Ayub was left with no option but to fund a large part of the annual budgets with the proceeds from selling wheat received from the US under a grant arrangement called PL480. This led to almost the total destruction of our wheat production capacity; resultantly from granary of the subcontinent we became net importers of wheat.

And Pakistan's defence budgets in those days used to be taken care of in a large part by the military assistance being received from the West under the CENTO and SEATO defense pacts. This aid used to come in the shape of tanks and fighter planes of Second World War vantage; even a number of cantonments were built during this period with the aid resources.

The interregnum provided by the nationalisation spree during the Bhutto regime is another story deserving a separate treatment.

Come the Zia regime with Ghulam Ishaq Khan holding the finance and economic portfolios. He too would not touch taxation but for running the government would borrow from nationalised banks at rates less than 06 per cent while the banks were mobilizing resources at 10-15 per cent. This was the surest way to destroy the country's banking system and keep a legitimate tax culture from taking roots in the country.

And it was about this time that the term users' charges was introduced in our social sector litany. We suddenly entered the luxury of free market economy.

And by this time the infamous multilateral aid agency, the Paris Club, had started dictating our annual budgets. Successive annual budgets were being framed on the basis of the anticipated project and non-project aid for the year which would be designed invariably to fit the economies of donor countries.

What the then economic managers of Pakistan had refused to see was that out of each dollar of aid which was actually a loan, 99 cents would go back to the donors in the shape of consultation fee, imports from donors dictated by transfer pricing system, shipping charges etc. And the residual cent would be siphoned off by the unscrupulous civil-military bureaucracy.

This is a short, sharp recall of how Pakistan gradually turned into a loan dependent country losing its political and economic sovereignty to the donors and obliged to do their bidding even if it meant doing something totally opposed to national interest.

And the last 40 years have added another dimension to Pakistan's need for borrowings. Pakistan has been in a state of war since about 1979 - the first Afghan war, the second Afghan war, the 10-year-long low intensity wars in the 1990s, one on the side of Taliban against Northern Alliance and the other on the side of Kashmiri freedom fighters against the occupying Indian troops, the war against TTP, the Rah-i-Raast, the Zarb-i-Azb and Ruddul Fasaad, cleaning campaigns in South Waziristan and North Waziristan.

And we all know wars are not fought on empty pockets. We fought both Afghan wars with the billions received from the so-called free-world including from China and oil rich Muslim countries. During the first Afghan war we received an unencumbered $50 billion as per rule of thumb estimates. But when Zia died in 1988 there was nothing on the ground to show where these billions had gone. In fact, the late Dr Mehbubul Haq who was the finance minister in the interim government of President Ghulam Ishaq Khan had to rush to the IMF for a paltry emergency assistance of about $150 million.

The question is, could a country fight wars for nearly 40 years on empty pockets—that is, while being totally dependent on loans with strings attached and country's own ability to increase domestic savings next to nothing?

The answer is too obvious. So, how did we fund these wars, then? Again, obviously by borrowing left and right without bothering about what would happen when the time came for repayment.

In the second Benazir government at the end of six months of its first year it was realized that revenues were not picking up. The government decided to enhance regulatory duties on a large number of import items. However, at the end of the year it was found that while the imports had gone up steeply, there was no improvement in the collection. The then PM was asked why it was so, at a press conference. She said she would also like to know the reasons and asked the journalists to visit the then CBR (FBR) chief and try to find out the reasons from him. The CBR Chairman passed the buck on to strategic imports which interestingly do not carry any duties!!!