<u>WIPING OFF THE NATIONAL DEBT</u>

(Mahbub ul Haq)

There is an opportunity today for an historic deal : to swap our domestic debt against our public assets and to rid our budget of ever increasing interest payments.

Pakistan's total domestic debt is now over 800 billion rupees (roughly $ 23 billion). Debt servicing on it exceeds Rs.100 billion in the budget. If this debt can be wiped off, there will be public savings equal to 6% of the GNP. Such a deal can dramatically lower our budget deficit, even while <u>doubling</u> public expenditure on social services (which is a must).

Let me make clear some basic premises before recommending such a debt-equity swap.

There is a false notion today that external debt is our real problem, not internal debt. This is imply not true. Out total disbursed and outstanding external debt is around $ 21 billion, requiring interest payment of Rs.25 billion a year. This is far more manageable than the annual interest payment of over Rs.100 billion on domestic debt. The plain fact is that we have accumulated our domestic debt at more onerous terms than our external debt. The average terms for external debt are a repayment period of about 30 years, grace period of 7 years, and average interest rate of 4%. But most of the domestic debt has been contracted at interest rates ranging from 12% to 18% and its repayment period is fairly short. What are described as National Savings Schemes in the budgets are, in fact, national borrowing schemes. The national debt that was accumulated in the past is now fast eating into the financial resources of an increasingly unviable budget. Either we take some bold policy action to wipe off this debt or it is likely to wipe off the budget.

But we are not destitutes as a nation. In fact, we possess sizable public assets. Most of these assets were created through incurring national debt. When we are in such a tight budgetary corner, why not sell those assets to wipe off the domestic debt? It is difficult to put a precise value on our public assets: telecommunications, power stations, gas companies, airlines, industries, banks, DFIs etc. But a rough estimate indicates that their market value would exceed our domestic debt. The public assets for a grand deal for debt-equity swap are available.

Some analysts shudder at this prospect. Why sell the "family silver"? The 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 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 may other countries, we shall have to set up a National Regulatory Authority so that any adjustment in rates is publicly discussed and debated and charges for utilities are increased only after making a through examination and reaching a national consensus.

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.800 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 soldiers and a flag, and colonized hapless nations. Today, computers buy foreign assets through international 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 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.

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 four years so that we enter the 21st century with a clean national slate. Any such strategy should be woven around the following five elements:

First, international and domestic markets should be prepared carefully for the sale of public assets by hiring some professional investment firms. If some assets are not ready for sale (like nationalised 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 the asset for peanuts.

Second, the entire public asset should be sold, not just a small portion. It makes no sense to sell an asset in small driblets : 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.

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.

Fourth, every penny received from the sale of public assets must be used for retirement of national debt - certainly not for current expenditure or debt servicing. The worst scenario will be if we pass on our debts to the next generation but not our assets.

Fifth, the revenues released from interest payments should be used both to provide essential social services to our people and to lower the budget deficit. If we proceed boldly forward, both these objectives can be achieved.

There is nothing new in this strategy. Many other nations have already followed it. Can we take such a bold step when the budgetary picture ahead looks so bleak?

The writer is President of the Human Development Centre (HDC) and Chairman of the Foundation for Advancement of Science and Technology (FAST).