

Turbulent times for Musharraf

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THE year 2007 has so far been rather difficult for General Pervez Musharraf of Pakistan. His junta seems increasingly isolated. While he is riding one political storm after another monsoon rains and cyclones have added to his administration's predicament. With provincial and national elections approaching later this year, Musharraf's administrative maturity and political acumen are on serious test.

Iftekhhar Muhammad Chaudhry, the Chief Justice of Pakistan was unceremoniously dismissed by President Musharraf on March 9. That incident quickly got out of control, leading to violent street battles that cost 41 lives in Karachi. The allegations against Chaudhry were serious enough for the president to show him the door.

Chaudhry was accused of misusing his office for securing a high-ranking job for his son in the Police Department. Chaudhry sympathizers say that Musharraf sacked him because he was too independent. He may have created difficulties for the military government in the upcoming legal battles ahead of the general elections hence the dismissal.

Protests over Chaudhry's removal gave the judiciary and the civil administration an opportunity to vent their anger against Musharraf and his military junta. The opposition political parties also joined lawyers protesting Chaudhry's ouster.

Protests degenerated into violence in the streets, leading to deaths of innocent civilians. In one such demonstration in Lahore, Chaudhry declared that dictators who ignored the rule of law faced "destruction."

The situation continued to worsen and, at one time, some analysts even predicted that Musharraf would be compelled to proclaim "emergency" to bring matters under control. While the chief justice episode was still simmering, a new threat stared Musharraf in the face. The militants of Lal Masjid threw a challenge to the authority of Musharraf.

Pakistan's Religious Ministry built the mosque in Islamabad in 1965, and named it "Lal Masjid" as its façade was built with red bricks. Its first Khatib, Maulana Abdullah, selected by President Ayub Khan, had two sons who are now running the affairs of the Lal Masjid. The two brothers Abdul Aziz and Abdul Rashid Ghazi, have been propagating "Jehadi fatwas" since the days of the Soviet invasion of Afghanistan.

Late President Ziaul Haq patronized the two maulanas by frequenting the mosque. Jamia Hafsa, a madrasa for girls was established in the mosque in 1992. Later Jamia Faridia for boys was also set up a few kilometers away under the mosque.

Trouble at the mosque began early this year, when the Maulana brothers set up anti-vice squads with madrasa students. Later, a Sharia Court was also set up to try so-called social vices. The two brothers Aziz and Ghazi demanded imposition of Islamic Sharia in Pakistan. Since early June, the mosque area had been surrounded by commando policemen.

Things got out of control when, in late June, the "vigilante" students raided a nearby massage parlour and seized six Chinese masseuses, allegedly for immoral activities. At this point, Musharraf had to sit up straight as Beijing reacted strongly, asking Islamabad to secure the release of it nationals unharmed.

The abducted Chinese were released three days later. But confrontation between the militant students and the police did not abate. Burqa-clad stick-wielding female students of Jamia Hafsa attacked nearby government buildings and police pickets. On July 2, when the

police asked the two Maulanas to surrender and let the students free the confrontation with authorities took an ugly turn. Several hundred students were trapped inside the mosque at that time.

Aziz was later arrested when he tried to flee, wearing a burqa, but Ghazi stayed with 50/60 militants to fight on. The final showdown came on July 10, when army commando units stormed the mosque and brought an end to the weeklong bloody drama. Maulana Ghazi was killed in the operation, along with his jihadi militants. According to reports 102 lives were lost, including those of 11 soldiers.

There are several intriguing questions, which have been left unanswered. Security in Islamabad has been foolproof since the previous assassination attempts on Musharraf. How did these fanatics carry such large quantities of arms and ammunition into the mosque under the very nose of the ISI? Was it a failure of the intelligence, or were the ISI an accomplice in smuggling these? After all, weren't the Taliban a creation of the ISI? Why did the government wait for six months to stamp out these bigots? Keeping the elections in mind, it looks like Musharraf did not want to meddle

with the religious groups.

When the judges and militants are testing Musharraf's nerve and resolve mother nature seems to have also joined hands to test his administrative ability. Monsoon rains and cyclone have devastated large areas in Balochistan and North West Frontier Province (NWFP). More than 900 people have died so far, and 1.5 million people affected by floods, causing massive damage to crops and infrastructure.

The administration is fully stretched trying to bring relief to the affected people. The president has been making frequent sorties to visit the affected areas. On July 7, when Musharraf's aircraft flew out of Rawalpindi for Balochistan, anti-aircraft fire was directed against his plane. Though the attempt on his life failed, and the government denied the attempt anti-aircraft guns and ammunition were found on the roof of a building near Chaklala Airport.

Not to be outdone by the jihadis, former prime minister Nawaz Sharif organized a mini-summit of several opposition political parties of Pakistan in London on July 11. The Multi-Party Conference (MPC) discussed ways to oust Musharraf and drew up strategies for the next elections in January 2008.

Interestingly, Pakistan People's Party (PPP) of Benazir Bhutto was conspicuously absent from the meeting, giving credence to rumours that Musharraf was negotiating a deal with Benazir for her to return to Pakistan on condition that he would continue as president and army chief.

Lal Masjid in now truly "Lal," with the blood of jihadis, students and soldiers. Between now and the national elections Musharraf is likely to face more challenges. There are already reports that Friday prayer devotees had demonstrated against Musharraf all over Pakistan on July 13.

The tribal areas are restless, and suicide bombings are on the increase. Anti-US sentiments are running high though President Bush has congratulated Musharraf for the mosque operation. The religious parties are denouncing Musharraf. The judiciary and the civil bureaucracy are alienated. The major political parties are up in arms.

Military leaders do not have a political constituency or a base from where they can claim legitimacy. Their authority comes from the brute firepower of the gun. It is only natural that they would seek controversial partners to gain legitimacy when they usurp power. Obscure religious



parties in Pakistan have always proved handy in the strategy of the military's continuing in power. What Pervez Musharraf's strategy will be for political survival, will be interesting

to watch.

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Reverberation of popular demands

Thankfully, the drive against the corrupt has already borne some fruit in the form of sentencing of some corrupt politicians, while other judgments will gradually be known. Thus, examples are being set. However, constant vigilance on the part of all stakeholders is the key, so that the corrupt cannot break away through any loophole of the law. It is quite understandable to apprehend that they will definitely hit back if they are provided with a little leeway.

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ARGUABLY, Army Chief General Moeen U. Ahmed's deliberations regarding home-grown democracy created a bit of an apprehension. Admittedly, however, his very recent suggestions against corruption truly reflected the thoughts of the conscious citizenry of the country. Yes, almost all his suggestions have already become people's demands, thanks to extensive awareness-building campaigns by the civil society groups and the media.

The army chief's recommendations include appointment of a parliamentary ombudsman, introduction of a "Right to Information Act," creation of a moral high ground against corruption, ensuring of exemplary punishment for all those found guilty of corruption, establishment of an independent and neutral judicial system, social boycotting of the corrupt, and carrying out of the drive against corruption and corrupt people on a regular basis.

While his recommendation of a pay-hike for the police is also a very sensible one, the net total of salary increase may need to be broadened

so that this very necessity of life in this land of constant price-hikes does not compel officials to go for corruption for mere existence. Though some officials tend to turn wanton while indulging in corruption just out of greed, inadequate salary is still a major hurdle to remaining honest for many opting to remain so.

Meanwhile, the provision for an "ombudsman" (article 77) in our constitution has been in place since its promulgation. Such is the irony that it could not be put in place in so many years. However, the previous government did appoint a tax ombudsman, the presence of which

is still to be felt. Though almost all previous governments toyed with the Anti-Corruption Commission, they used it less as a tool for combating corruption and more as a weapon for harassing the opposition.

Truly, the contemporary war on corruption has been identical with cleaning the Augean stable of unclean politics that has mostly been at the root of all ills, or in other words, the mother of all evils.

For a nation, the majority of whose people are hard working, peace loving, and honest, the stigma of most corrupt country in the world for five consecutive years is indeed gross injustice. Thus, the people have not even an iota of sympathy for the corrupt who imposed such a blight upon them.

It is because of this that the army chief, like many others, feels that the war on corruption needs to be endorsed as an on-going process by the next elected government, and carried on with equal enthusiasm because it has now become a popu-

lar agenda. Truly, never before had criminals and the corrupt been brought to face their crimes and, perhaps, none in the country ever imagined that they would one day be made to repay their debt to the nation.

The general very rightly called for a "Right to Information Act" so that corrupt officials could not hide behind the cloak of secrecy and escape punishment. In Bangladesh, the Official Secrets Act (1923), the Evidence Act (1872), Penal Code, the Code of Criminal Procedure (1960), and the Rules of Business (1996), are the major laws that restrict people's rights of access to information. Instead of serving the national interest, the laws became paws in the hands of the state machinery.

While the crusade against the corrupt politicians is very much on course, the campaign against the corrupt officials has yet to gain the required momentum. However, exonerating them for fear of non-

cooperation in state functioning may ultimately cancel out the very reason for the current anti-corruption drive.

Many of our officials are honest. However, the number of corrupt ones is not meagre either, which fact must have been further reinforced by the shenanigans of Osman Gani and other forest officials.

Many, thus, termed the forest officials' corruption as just the tip of the iceberg of the corruption that had been practised in the officialdom over the last 36 years. Though politicians plundered the resources of the country for specific periods, many officials had the opportunity to misappropriate public funds and extort bribes for their entire tenure. To be candid, the network of the corrupt percolates down to every single corner of the country.

Interestingly, however, the plea for boycotting the corrupt socially is critical, and calls for a sea change in our attitude. Admittedly, corruption has become monstrous in Bangladesh. However, equally

disconcerting was the fact that people seemed to have developed a benumbed acceptance of it. In fact, corruption is a consequence of the way of life in our acquisitive society, where people are judged by what they have rather than by what they are.

This tendency inevitably results in a scramble for the possession of glittering prizes, irrespective of the means adopted. In Bangladesh, the vampire of corruption grew so recalcitrant that the ones against it became anachronisms.

Rather than arresting the voyage down the drain, the politicians in collusion with corrupt officials constantly fuelled that erosion, for which many of whom have already landed in the place they have long been overdue in.

Thankfully, the drive against the corrupt has already borne some fruit in the form of sentencing of some corrupt politicians, while other judgments will gradually be known. Thus, examples are being set.

However, constant vigilance on the part of all stakeholders is the key, so that the corrupt cannot break away through any loophole of the law. It is quite understandable to apprehend that they will definitely hit back if they are provided with a little leeway.

Thus, uninterrupted continuation and reinforcement of the anti-corruption drive is required more for the general people and less for the current government though some fear a backlash against the people in the current administration if the jailed leaders and criminals get an opportunity ever because the people in the interim government are unlikely to be within their reach forever but the masses will always be there to bear the brunt of their vindictiveness. Such a day should, however, never come along.

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Fighting inflation in Bangladesh

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FEW subjects invite as much public emotion as the topic of inflation. Inflation reduces the purchasing power of consumers and there is strong global evidence that in democratic countries inflation affects electoral outcomes. There is also evidence that inflation hurts the poor more than the rich and anti-inflation policies are one important way to reduce poverty. Given this strong socio-political influence of inflation, it is understandable why inflation tends to worry governments more than any other economic problem. In Bangladesh the recent increase in inflation has drawn national attention. It is worrying both the people at large and the caretaker government. Various theories of why the rate of inflation has increased have been offered including a populist perception that inflation is caused by trading mafias (syndicates) who are hoarding goods and thereby driving up prices to make windfall profits. Such populist views have been lent credence by anti-hoarding measures taken by the government including crackdown on business inventories and setting up of fair price shops by para-military forces (BDR shops). Some have blamed the cost-push

pressures emerging from increases in world commodity prices, especially foodgrain and petroleum. Linked to this there is a populist demand to insulate the domestic economy from these price increases through various administrative means including price controls.

Clearly, there is considerable misunderstanding of what causes inflation in a modern globalized economy and what policies are needed to fight inflation in a sustained manner. The objective of this article is to attempt to explain the underlying causes of inflation in Bangladesh and what could be done to reduce inflation without jeopardizing other economic goals.

It will be helpful to start with the basic economics of what causes inflation in a modern economy that is also inter-connected with the rest of the world through trade and capital flows. Nobel prize winning Chicago economist Milton Friedman had long ago shown conclusively that in the ultimate analysis "inflation is a monetary phenomenon". Using the classic quantity theory framework Friedman demonstrated that over the long-term the rate of inflation is simply the difference between the rate of growth of money supply and the rate of growth of real output (GDP). So, the only viable

long-term solution to the inflation problem is to align the rate of growth of money supply to the rate of growth of real GDP and the target rate of inflation. Short-term divergence between the rate of growth of money and inflation is possible, but when inflation is on a rising trend, the usual culprit is an excessive pace of monetary expansion. Accordingly, it is no surprise that Central Banks globally tend to cure inflation through monetary policy. This is true of Central Banks in advanced economies as well as in developing economies. Indeed some autonomous monetary authorities pursue monetary policy with the sole aim of inflation control.

Yet, often some Central Banks, especially in developing economies, tend to show reluctance to tighten money supply to the required extent to fight inflation. What explains this reluctance? This partly reflects the lack of autonomy in the conduct of

monetary policy. For example, borrowings by the Treasury to finance fiscal deficit may dominate monetary management. But it partly reflects a belief in the "structuralist approach to inflation". The structuralist view argues that monetary tightening could hurt economic activity through increase in the interest rate. In this view there is a trade-off between inflation and growth. So, instead of monetary tightening, structuralists argue that measures should be taken to reduce the structural bottlenecks that cause cost-push inflationary pressures. This could be a combination of investments to reduce supply shortages of key commodities as well as controls over sensitive prices such as exchange rates. Empirical evidence is unclear about the validity of this approach to inflation control. Indeed fighting inflation through control over

Yearly average rate of growth	CPI	World CPI	World food prices	Exchange rate depreciation	Money supply (M1)	GDP growth
FY2002-04	5.5	3.6	9.7	1.0	11.0	5.8
FY2005	6.5	3.6	-0.3	4.4	16.8	6.0
FY2006	7.2	3.5	9.8	9.3	21.3	6.6
FY2007 (April)	8.3	3.5	9.3	-0.7	21.3	6.5 (est.)

exchange rate and other sensitive prices like energy prices could either hurt other objectives (balance of payment management) or could even be self-defeating (subsidies resulting from price controls might overwhelm public finance leading to excessive monetary expansion owing to deficit financing and fuel further inflation).

Let us now turn to the Bangladesh situation. The movements in key variables affecting the inflation rate in recent years are shown in the table below. To define money supply, I use the narrow concept of money (M1) because this more appropriately defines the transactions demand for money which is most relevant for spending purposes. However, the results are not that much affected by this choice because the pattern of broad money (M2) growth is broadly similar. The table shows that the rate of inflation has been rising noticeably since 2002-2004 with the pace creeping up by roughly one percentage point every year since then. As a result, the rate of inflation accelerated to 8.3 percent by April 2007. What has caused this increase in inflation? GDP growth has been relatively stable in this period with a slightly upward trend, rising from an average of 5.8 percent in FY02-04 to an estimated 6.5 percent in FY07. This suggests that the aggregate supply side developments in terms of growth of output have been fairly positive. Cost push pressures through world inflation have been broadly similar over the past 5 years and the rate of world inflation has been consistently and substantially lower than the Bangladesh inflation. Although exchange rate changes did contribute to cost push pressures in FY2006

relative to FY2002-04, this was not a factor in FY2007. World food prices, however, have continued to exert considerable inflationary pressure throughout the 5 year period except for a hiatus in FY2005. Looking at all the cost push factors and combining them with the rate of output growth, we get a mixed picture about the role of cost push pressures in generating and sustaining inflation. There is no evidence of a supply side shock. The only consistent factor has been the pressure exerted by world food prices. Given the large share of food in CPI and linkages with nominal wages, this is likely to have been an important determinant of inflationary pressures in Bangladesh and other South Asian countries in recent periods. The other factor that might have contributed somewhat to the cost push pressures is adjustments in petroleum prices since 2003. However, given the direct small weight of petroleum products in CPI and the relatively low energy intensity of production, it is unlikely to be a major determinant of domestic inflation.

The story on the demand pull factors is however quite telling. Along with rising income emerging from increasing GDP growth, there has been a substantial growth in money supply. Rising from an average growth of 11 percent per year during FY2002-2004, money supply growth accelerated to around 17 percent in FY 2005 and then surged to over 21 percent in FY2006 and FY2007 (April). Given the relationship between rate of growth of money supply, output and inflation, it is hardly surprising that we observe growing inflationary pressures in Bangladesh. Some of the excess

money growth is likely to have also spilled over to an increase in asset prices, especially real estate. On the whole, unless the rate of monetary expansion falls significantly it is likely that inflationary pressures will continue.

The experience of other South Asian countries also provides useful light on this point. All South Asian countries have faced inflationary pressures in the past few years because of rising commodity prices including food and fuel and growing demand pressures from rising incomes. India responded quickly by tightening monetary policy in a rapid succession of policy interventions. As a result, interest rates rose, demand pressures were down and inflation fell from a peak of 6.7 percent in February 2007 to 4.3 percent in June 2007. There was little adverse effect on growth, which is estimated to stay at a healthy 8.5 percent in 2007. Pakistan responded more hesitantly with some monetary tightening, but a combination of fixed nominal exchange rate along with generally accommodating monetary policy has kept inflation at 7-8 percent while the current account of the balance of payments has widened substantially. Sri Lanka failed to tighten monetary policy while also maintaining loose fiscal policy partly in response to the financing of the ongoing civil war. The result has been a rapid growth in money supply and a surge in inflation to close to 20 percent per year.

These experiences including from Bangladesh reinforce the obvious result from standard macroeconomic theory that there is no substitute for prudent macroeconomic management. A policy of controls will not

work. In particular, on a sustained basis inflation can only be cured through monetary tightening; similarly, sustained balance of payments management requires flexible management of exchange rate. What about the possible adverse effects on growth? If there is a temporary supply shock, such as crop failure from droughts, this can be accommodated through short-term fiscal and monetary accommodation. But a permanent increase in world prices of food and fuel, for example, will require that these increases be passed through to consumers. Any attempt to artificially control them through restrictive policies will not be sustainable. Neither will they allow lower inflation on a sustained basis. Such efforts will raise the budget deficit and unless taxes rise in tandem, the result will be deficit financing, monetary expansion and higher inflation. Indeed, this is a part of the story in Bangladesh where efforts to keep domestic energy prices low despite rising international prices caused a huge build up of deficits in the energy utilities that were funded through bank borrowings which have fed into monetary expansion.

The inescapable conclusion therefore is that the recent increase in inflationary pressures in Bangladesh requires monetary tightening. Interest rates will rise, which is a part of the necessary adjustment to reduce demand and lower inflation. Fortunately, the government has taken some steps to tighten money recently and the rate of expansion of M1 fell from 21 percent to 19 percent in May. The rate of inflation has also fallen somewhat from 8.3 percent to 8.1 percent. This is a welcome development but further tightening is necessary to bring down inflation to the 4-5 percent range.

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