SUSTAINABILITY OF PAKISTAN’S ECONOMIC FUNDAMENTALS

Ishrat Husain

It is quite established by now both within and outside the country that the economic fundamentals in Pakistan have taken a turn for better during the last four and a half years. For the first time Pakistan has successfully completed a four-year programme with the IMF and has decided to exit from its supervision and monitoring. The international financial markets have reposed their confidence in the strength of Pakistan’s economy by oversubscribing to Pakistan’s Eurobond floatation at fine prices. The domestic capital and financial markets have never been so buoyant as they are these days.

The question that agitates the mind of both Pakistani and foreign investors is: How sustainable are these economic fundamentals? Will they change significantly with the change in political or economic leadership? Are these fundamentals overly dependent on the goodwill and support of the U.S.A.?

Let me address these very legitimate questions by submitting that in a rapidly changing globalized environment no single country is fully immune from the developments elsewhere in the world or insulated from the turbulences and disturbances of business cycles. Neither can Pakistan isolate itself from the unanticipated shocks either international or domestic. The important thing is to assess how robust the economy is in withstanding these shocks and making adjustments at the least possible costs.

It is fair to surmise that, unlike in the past, when every little shock destabilized the economy and created instability the track record of the last few years suggests that Pakistani economy has survived four serious shocks without any major dislocation. A prolonged drought for three years hurt our agriculture sector and the rural economy in a big way; the Sept. 11 incident transformed Pakistan into a front line state with all the negative consequences associated with it; the mobilization of Indian troops on Pakistani

Speech delivered at the Oil and Gas Conference 2004 held at Islamabad on May 3, 2004.
borders intensified the tension with our neighbor and the terrorist killings in Karachi and elsewhere painted a grim picture of the country world over. Despite these adverse shocks Pakistani economy has recorded growth rates of over 5 percent, with low inflation, registered a surplus external account, maintained a stable exchange rate, attained low interest rates and hardly any speculative attacks on currency or equity markets.

Why should any one believe that the same stability and orderly conduct can be expected in the future? After all, there have been serious reversals in the recent past i.e. in the decade of the 1990’s Pakistani rupee was depreciating at an annual rate of 10 percent, growth was anemic, inflation was high and the country faced difficulties in meeting its external payment obligations. What is the difference this time around?

In my assessment, at least three sets of considerations have made the difference. First, there have been some irreversible changes in the economic landscape. Second, there has been institutionalization of reforms, and finally, there has been a realization that lack of continuity and consistency in economic polices has huge political cost.

What are the changes that cannot be reversed in the future? The link between the government and business has been severed or weakened through privatization of public state owned enterprises, through separation of policy making and regulatory oversight functions, through devolution of powers to lower tiers of government, through introduction of greater transparency and disclosure and reduction in the discretionary powers of the government officials. In the financial sector, for example, 80 percent of the banking assets are owned and managed by the private sector banks in a healthy competitive environment under the strong vigilance of the regulator. Credit allocation is no longer dictated by the government officials and leaders and the efficiency in the system thus attained has resulted in lower cost of capital in Pakistan compared to other competitor countries. I cannot imagine that any future leadership will dare to nationalize the banks. Every single major political party is committed to privatization and has done so in actual practice.
Another example is from your own sector i.e. oil and gas. The mandate of the Ministry of Petroleum and Natural Resources has been curtailed to policy making responsibilities while quasi-judicial independent regulatory agency OGRA has been set up to regulate the sector Oil and Gas pricing are no longer at the whims of the Ministry. Neither it is any longer a monopoly importer of crude and PoL products. Boards of directors have been appointed from among the private sector to run the state owned companies. I do realize that the old habits diehard and that we haven’t attained perfection but at least a major shift has taken place which will be hard to dispense with. I can go on with many more examples such as the end of PTCL monopoly and deregulation of the telecom sector, unbundling of WAPDA and privatization of generation and distribution companies but suffice to say that the scope for any government to interfere in the operations of the businesses has been reduced and more will be done this direction in the future. Although cultural change and change in mind set will take sometime it would be very difficult for any future government to aim at status-quo ante.

The second factor that heavily impinges upon the sustainability issue is the institutionalization of changes that have taken place or are likely to take place in the near future. For example, the State Bank of Pakistan, SECP, Auditor General of Pakistan, the National Accountability Bureau have been strengthened and given full autonomy and independence to provide oversight, detect irregularities and to take to task individuals and companies that are violating rules and regulations. CBR is also undergoing restructuring and the recent move to introduce Universal Self assessment scheme is an attempt to minimize interaction between taxpayer and tax collector. Tax payer will file his own assessment of income tax and only 20 percent of the returns will be scrutinized by audit. Thus the extortion, harassment, under the table payments and wheeling dealing will all come to an end under this system.

Government’s own lack of fiscal discipline has been one of the major contributory factors to Pakistan’s indebtedness. A Fiscal Responsibility Law is before the Parliament and this law will put a statutory limit on fiscal deficit and public debt. Hopefully this restraint on the Government’s spending will ensure that fiscal discipline remains in place.
Pakistan has made commitment to the World Trade Organization (WTO) to liberalize its trade of goods and services. In fact, it has taken unilateral measures to reduce tariffs well beyond its binding commitments and, also, removed non-tariff barriers. Openness to trade has brought about benefits to both the consumers as well as producers and the case for protectionism and subsidies to particular segments of producers has become much weaker. It is unlikely that the door against openness to trade will be closed in the future.

Similarly, the usefulness of foreign direct investment whereby foreign investors can bring in their capital and repatriate their earnings, profits, debt servicing, royalties, technical fees and even capital, without with restrictions or approvals, has been widely accepted by all major political parties. This policy has been practiced for a long time and survived several changes in political regimes. Thus, there is hardly any risk that foreign investors will be discouraged from doing or expanding business in Pakistan.

Finally, there is a widespread recognition and realization that Pakistan has suffered in the 1990s due to lack of continuity and consistency in economic policies, programmes and projects.

The transition in October 2003 from the Military-led Government to the democratically elected Government provides clear evidence of this recognition as the policies and programmes adopted in post October 1999 period have been continued by the newly elected government. This will be further tested in 2007 when a new government assumes power and if it also provides the continuity and consistency in policies Pakistan would be clearly on a path of sustained higher growth and accelerated poverty reduction. All major political parties are committed to the same set of broad economic policies and while they may differ in the modalities and nuances the broad thrust of policies aimed at privatization, deregulation and liberalization will remain intact. The political leaders have also realized that by reversing these policies and programmes they incur all the political costs but derive no tangible political benefits. They will be
better off if they complete what was started by their predecessors and get political mileage out of it.

**What are the Risks that can affect the Sustainability?**

First, there is an urgent need for change in the culture, attitudes and mind-set of both the private sector and the bureaucracy. We have to move away from an adversarial and confrontational relationship to that of partners in national prosperity. The imperatives of global competition call for a different value set – i.e. of cooperation, collaboration and problem solving – rather than finding faults in each other and blaming the others.

Instead of a negative, stop the other from doing anything attitude, we have to adopt a positive, facilitating mode focusing on how can we help each other and find a solution to the problem at hand. The colonial and feudal mind set on the part of both the private and public sector has to give way to a more symbiotic relationship. This is the biggest challenge for us as we have competitors such as East Asian countries where this mind set and value system are fully entrenched.

Second, the implementation capacity and institutional decay have become a major obstacle. We have to inculcate professionalism, expertise, competence and systems to make our civil services, meet the realities of the 21st century. The nature of the government has dramatically changed while implementation capacity of government policies, programs and projects as well as the delivery of the public services has been seriously impaired. Poor governance, inertia, inaction, lack of knowledge have spawned a culture in which wasteful expenditures, leakages of resources and low efficiency are the norm. Sound policies cannot see the light of day until our institutional capacity is strengthened and reoriented. Public-private-community partnership provides a way forward.
Third, the legal and judicial system is out-of-sync with the requirements of modern business practices. Contract enforcement, sanctity of property rights and dispute resolution mechanisms leave much to be desired. Congestion of courts, cumbersome and time-consuming procedures, inadequate training of Judges in commercial and banking laws and physical infrastructure facilities are some of the constraints for the present state of affairs. Reforms of laws and judiciary should be given priority.

Fourth, there is a risk that the privatization process may be slowed down due to the interplay of vested interests. This process has to be accelerated to promote efficiency of resource use, avoid a continued drain on fiscal resources and improve delivery of essential public services. The businesses in Pakistan will gain competitiveness if the energy costs are contained and the middle will have larger disposable income to consumer if their household expenditure in energy is curtailed. The sooner we privatize KESC and the distribution companies of WAPDA the better off the economy will be.

Finally, the most important missing link in Pakistan’s competitive edge and a serious threat to its economic progress is the poor indicators of human development. Adult literacy and the skill level of our labour force are low, health status is precarious with low productivity and high absenteeism and gender disparities are large. We have to devote more attention and resources to invest in our education, health, nutrition and gender programmes to equip our labour force to excel.

These risks have adverse consequences for our economy in the future but they can be managed and mitigated if we set our minds and energies on tackling them. There is no reason in my mind, that Pakistan cannot enter the global race for prosperity that characterizes the 21st Century.