

PAKISTAN'S ECONOMIC PROGRESS SINCE 2000:

FALSE DAWN OR A PROMISING START?

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The recent turnaround in Pakistan's economy has evoked two different kinds of responses. There are observers who argue that the economic progress made by Pakistan since 1999 is a mirage and a false dawn and that the economic structure, processes and fundamentals have not changed much. There are others who believe that the country has made a promising start and that the reforms undertaken during the last five years are sustainable and this will change the economic landscape of the country over time.

The arguments advanced by the 'false dawn' proponents are, however, quite varied. A well-respected American scholar on South Asia observed at a recent seminar on the Pakistan economy that the economy thrived during the periods when Pakistan-US relationship was strong i.e. the Ayub (1958-1969) period, the Zia years (1977-88) and more recently, the Musharraf era (from September 2001 onwards.) This postulate is also shared by a number of Pakistani intellectuals, particularly those who have an ideological revulsion to military rule in Pakistan.

A second and popular refrain is that the economic gains made by Pakistan are all due to the fall out of September 11 and, therefore, these gains are not sustainable. Sooner or later our economic condition will revert to the situation that prevailed in the 1990s.

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A third reason in support of the “false dawn” theory is that Pakistan is so much entangled in a web of intricate geopolitical problems that its defence expenditures crowd out development expenditures and that the country will, therefore, continue to remain vulnerable and in an economically precarious condition. Furthermore, it is also asserted that the growing military industrial complex is eroding the productive economic base of the country.

The purpose of this paper is to examine the validity of each of the above propositions and come to some conclusions about the nature and strength of the Pakistani economy, in addition to offering some comments about the sustainability of reforms in the coming years and the risks posed to these .

U.S. Dependency Thesis:

It is true that the Pakistani economy has performed extremely well during the three periods of Ayub, Zia and Musharraf. But the question we have to ponder is: was it due to U.S. or external economic assistance that the economy performed well or was there some other alternative hypothesis that explains this phenomenon. Let us look at the empirical evidence. If the U.S. and foreign aid is the main explanatory factor, we should observe this in the increased flow of foreign savings during the military period. The data from the Ayub period is not comparable as it includes East Pakistan as well. Thus, for purposes of this analysis, we confine ourselves to the period beyond 1971. The evidence shows that Pakistan’s current account deficit was 6.5 percent of GDP on average in the 1972-77 period, financing 40 percent of investment outlay.¹ It was 6 percent of GDP during the 1990-99 period, the most recent non-military period. In other words, more than one third of investment was financed from external borrowing and grants as against 20 percent in the 1980s i.e. the Zia period. In the four years under the Musharraf Government (2000-2004), the country in fact, generated a current account surplus, thus exporting capital to the U.S. and other developed countries rather than obtaining foreign flows. Besides repaying and

¹ Parvez Hasan, Pakistan’s Economy at the Cross-roads, Chapter 4 (Oxford University Press, 1988)

pre-paying a large amount of external debt and liabilities, the country has accumulated \$12 billion plus in foreign exchange reserves compared to an average of \$1 billion in the 1990s.

This can be further substantiated by the movement of net external transfers i.e. gross disbursement of foreign loans and grants minus debt servicing. Net external transfers were the highest during the 1990-99 period, compared to the 1980s and 2000-04 periods. (Table I). This does not include the \$11 billion of foreign currency deposits of residents and non-residents which were used by successive regimes in the 1990s for financing balance of payments deficits and were ultimately frozen in May 1998, striking a blow to depositor confidence. Despite these high net external transfers, growth rate was below the trend in the 1990s, poverty incidence resurged to 33 percent and fiscal deficits were unmanageable.

While the observation that Pakistan thrives economically when relations with the U.S. are at their best is empirically true at a superficial level, a more nuanced analysis suggests that it is what economists call “spurious correlation.” Two un-related events may occur at the same time but their cause-effect relationship may be statistically insignificant.

September 11 Windfall:

This brings me to another popular proposition that the economic gains made by Pakistan are all due to Pakistan’s participation in the war against terrorism and the resulting largesse by the U.S. As such, these are all transitory and short term gains and have nothing to do with the quality of economic policies and governance. This line of reasoning completely ignores key developments prior to September 11, 2001. Table II presents the key macroeconomic indicators for two years prior to 1999 and two years immediately before September 11, 2001. It is quite clear from this evidence that the country had not only safely overcome a default situation but, while economic sanctions were still

in place and external aid flows had turned negative, debt servicing payments amounting to almost \$9 billion were made during the two years prior to September 2001. This was done out of the country's own resources and within the timeframe agreed upon. Foreign exchange reserves had risen to \$3.2 billion by June 2001 from a sum of \$1.7 billion. Inflation was contained to approximately 4.4 percent. Exports had risen from \$7.8 billion in FY99 to \$9.2 billion. Tax revenues showed an impressive increase of almost Rs100 billion - from Rs.308 billion to Rs.392 billion by June, 2001 – a 14 percent annual growth. Fiscal deficit was brought down to 5.3 percent of GDP from 6.1 percent. Current account had turned surplus to 0.6 percent of GDP from a deficit of 3.8 percent. The exchange rate had become stable since June 2001.

Pakistan had successfully completed a 10-month stand-by program with the IMF and had finalized negotiations of a three-year Poverty Reduction and Growth Facility (PRGF), well before September 11. This agreement was the basis of bilateral debt restructuring under the Paris Club, relieving Pakistan of strains caused by excessive debt. Similarly, multilateral assistance from the World Bank and the Asian Development Bank on soft terms had resumed in fiscal year 2000-01.

It is obvious that improved economic policies and governance had started to yield initial results in the form of improved macroeconomic indicators before the September 11 event but there is no doubt that this event helped the country in several ways. Economic sanctions were withdrawn, grant assistance of about \$1 billion was received from the U.S. and another \$1 billion of bilateral debt was waived off. But the most favorable development was that workers remittances, which used to be channeled through informal sources, began flowing through the official inter-bank foreign exchange market. This diversion of worker remittances to the official economy certainly helped build up the reserves to an exceptional level, and contributed to exchange rate stability and its appreciation besides providing liquidity to the money market. In the absence of September 11 it would have taken longer to reach these targets. On the other hand our exports, which

were suppressed after September 11, would have been much higher than what they are today. Buyers stopped visiting Pakistan, insurance premiums went sky high, freight rates to and from Pakistan escalated sharply. The domestic security situation worsened as terrorists retaliated against the action taken by the government. Thus, the costs incurred by Pakistan for its participation in the war against terrorism should be weighed against these benefits.

While it is to be acknowledged that September 11 did help the country, the economy had begun to show signs of stability well before this event as a result of sound economic policies and good governance. It would be fair to surmise that in the absence of post September 11 developments, it would have taken a couple of years longer to observe the results we are witnessing today, but the direction set in December 1999 was right.

Defence Crowding Out Hypothesis:

Pakistan is located in a tough neighbourhood and given its history, it has had to allocate large sums of public finances for its defence. But the popular perception that Pakistan’s economy had been bleeding due to an exceptionally high commitment of public expenditures towards defence at the expense of development is not borne out by an appraisal of hard evidence. Defence expenditures in real terms (as percentage of GDP and as a percentage of public revenues and as a percentage of total expenditures) have been on a downward path since 1990.

	<u>% of GDP</u>	<u>% of Revenues</u>	<u>% of Expenditure</u>
1990-91	6.9	39.4	24.8
1995-96	5.6	32.5	23.1
2000-01	4.0	23.7	18.3
2003-04	3.8*	22.7*	19.5*

* The increase reflects the expenditure incurred on logistical support provided to the U.S. troops.

It was only during the 1980s when Pakistan was engaged in the Afghan resistance movement that defence expenditures jumped from 5.4 percent of GDP in 1979-80 to 7 percent in 1987-88. More recently, after the war against terrorism in Afghanistan, defence expenditures, which were declining, began to inch up again.

Defence expenditure, which used to account for about 7 percent of GDP in the early 1990s, declined to 3.8 percent in 2003-04. As a proportion of government revenues and total expenditure, the slide is even steeper. Thus, the attributed trade-off between defence expenditure and development does not exist. While it is true that Pakistan should spend relatively more on social sectors, the constraint was the ever-increasing debt servicing burden during the 1990s rather than defence expenditure.

Some commentators have also been propounding the belief that the military is gradually expanding its industrial empire through acquisitions and implementation of new projects by the Fauji Foundation, Army Welfare Trust, Shaheen Foundation, Bahria Foundation, etc. Although the end-use of the profits generated by the enterprises owned by these foundations and trusts are exclusively utilized on the welfare of the retired military personnel and their families, the rhetoric about their dominance in the industrial and financial sectors has taken a life of its own.

Most large industrial and financial enterprises are listed on the stock exchange. Information about their performance is available publicly. Table III shows that among listed non-financial companies, the combined assets of all military owned and related companies account for 5.53% of total assets of listed non-financial companies. In the financial sector (banks, NBFIs, insurance companies) the combined assets of the military owned and related companies

are only 2.89% of total assets of the listed financial sector companies. As several large banks are not yet listed, their overall share in the assets of the financial sector will be much lower than this figure of 2.89%. If we take the aggregate picture, the share of the “Military-Industrial-Financial Complex” does not exceed 3.6 percent of all listed companies. Are these indeed such a predominant player that they are displacing the civilian ownership of assets in the country?

Alternative Hypothesis:

We have, therefore, to analyze as to what were the main contributing factors to the better economic outcomes during military rule. Why was the record much better?

Although a number of scholarly treatises have analyzed such periods but none comes to the conclusion that it was U.S. economic assistance that was responsible for higher than average growth. My own reading of the evidence suggests that there are at least four main reasons that can reasonably explain this phenomenon.

First, the elected governments, except that of Mr. Z.A. Bhutto, had short survival rates and none of them could complete their term of office. During 1947-58, we witnessed seven changes in the office of the prime minister. The same trend was repeated in the 1988-99 period when four elected and four caretaker prime ministers were installed in quick succession. This lack of continuity in policies and management and the uncertainty created by the ever-shifting leadership at the top affected investment adversely in the two periods of 1950s and 1990s and a reversal of high growth trajectory observed in the 1960s and 1980s.

Second, the Bhutto government which completed its full term and served the country for almost six years reversed the predominant paradigm of liberal

economy and nationalized banks, insurance, large scale manufacturing industries, educational institutions, etc. This caused a serious setback to an economy that was advancing rapidly and whose manufactured exports in 1969 exceeded the combined exports of Thailand, Indonesia, Malaysia and the Philippines. Although counterfactuals are hard to construct, I leave it to the imagination of the audience as to where Pakistan would have been today had it continued the same set of liberal policies that it was pursuing in the 1960s. The aftermath of nationalization had its debilitating effects for a long period of time.

Third, the military governments were not constrained by the din, noise and messiness of democracy. I personally believe that for sustainable and equitable economic development, orderly and predictable rules of transition and change in the government are extremely important and there is no other form of government except democracy that can assure this. But the fact of the matter is that Korea under Park, Chile under Pinochet, Indonesia under Suharto, Singapore under Lee Kwan Yew, China under the collective leadership of the Communist party and Pakistan under Ayub, Zia and Musharraf have been able to carry out difficult structural reforms. Governance was relatively much better and accountability for results was more pronounced in these eras of authoritarianism.

Fourth, the efficiency of public sector resources for development was quite low during the 1990s. A well informed scholar has aptly described this period in the following way:

“The effectiveness of public sector development suffered because political pressures in the choice of projects and implementation arrangements became quite overt, the institutional capacity for review and appraisal of projects was further weakened and diffused, and the economic policy coordination arrangements for setting economic priorities tended to be bypassed money tended to be spread thinly over a large number of

projects with no clear focus on high priority projects whose completion, and thus benefits, were delayed”.²

It is my judgment that politically unpopular but desirable economic decisions could not have been possible under an elected government at a pace that was attained under authoritarian regimes. This is by no means a blanket endorsement or advertisement for such regimes, but simply a statement of an unpopular truth. Democracy, which requires consensus and compromise, may slow down the pace of change and cause setbacks and reversals from the path of reforms but there is greater legitimacy, broader support and better prospects of sustainability under a democratic form of government as it is built upon participation and reconciliation of differences among various interest groups. This political set-up will be able to weather unanticipated shocks more adequately than any other form, as democratic institutions work as safety valves that prevent conflict from becoming the prevalent mechanism for allocating scarce resources in the economy. The tension between democracy and good governance was not satisfactorily resolved in the case of Pakistan.

Economic Progress Since 2000:

I will now attempt to address the following questions: (a) What is the nature and the strength of economic reforms undertaken since 2000? (b) What has been achieved so far and what is the unfinished agenda? (c) How sustainable are these reforms and what are the risks to their sustainability?

Before addressing these questions, it would be appropriate to say a few words about the legacy that the Musharraf Government had inherited in October 1999. The salient features of this legacy were:

- Serious external payments crisis threatening imminent default.
- Declining economic growth.

² Parvez Hasan, IBID page 282

- Stagnant exports.
- Falling revenues.
- Growing debt burden
- Rising poverty
- Poor state of social indicators
- Deterioration in governance.

How did the new government go about dealing with these problems? It formed a small working cabinet consisting mainly experts and technocrats in their respective fields. These individuals were selected on the basis of merit and integrity. A new team of economic managers was commissioned and expatriate Pakistanis working in international institutions were invited to be part of this team. A strategy of economic revival was formulated and announced by the President on December 15, 1999.

Several committees, task forces and working groups were constituted with experts drawn from both within and outside Pakistan to make recommendations on the content, phasing and implementation timelines of various reforms. The most important committee was on Debt Reduction Management headed by an ex-Chief Economist of the World Bank and this committee's recommendations formed the basis of subsequent actions in this area. Another committee, under the leadership of a former Senior Vice President of the World Bank, and assisted by consultants from the Lahore University of Management Sciences submitted a blue print for the reform of the Central Board of Revenue. Another group was commissioned to review financial sector reforms and the services of several ex-World Bank staff were secured for this purpose on a full time basis. An Agriculture Taxation Committee, headed by a former planning secretary, produced a consensus view on the introduction of agriculture tax by provincial governments. An Interim Poverty Strategy Paper was developed in consultation with stakeholders from both within the government as well as from civil society, laying out the broad contours of the road map for economic policies and reforms.

Once it was agreed among the policy makers that the immediate problem facing the country was loss of credibility and a crisis of confidence, the next logical step was to bring about macroeconomic stability, the restoration of confidence among domestic economic actors and overseas Pakistanis and re-establishing credibility among international financial institutions. The strategy adopted to put these objectives was:

- a) To effect a sustainable reduction in debt ratios.
- b) To reduce fiscal deficit through revenue mobilization.
- c) To restructure key public sector institutions and plugging their losses.
- d) To pursue a prudent monetary policy and hold inflation down.
- e) To liberalize the foreign exchange regime and allow market forces to determine the level of exchange rate.
- f) To create a level playing field for all economic actors.

These macro stabilization measures were accompanied by structural reforms, improved governance and by re-establishing relationships with international financial institutions. An agreement with the IMF was negotiated for a 9-month stand-by programme in November 2000, as the IMF management was reluctant to resume the suspended medium term facility in the absence of a demonstrated track record of tough policy actions by the new government. This agreement was successfully implemented and all conditionalities were met well before September 2001 and this led to the negotiation of a three-year Poverty Reduction and Growth Facility (PRGF). Similarly, the World Bank and ADB also provided quick balance of payments assistance in 2000 and 2001 as Pakistan carried out all the reforms agreed with them.

There is a strong reason to believe that the changing structural, policy, governance, property-right and pricing arrangements put in place since 1999-2000 have resulted in a fundamental shift in the way Pakistan's economy is managed. What has been achieved during the last four years? I will not go into

the details of each of these reforms³ as they are amply documented elsewhere, but will simply list them for the sake of comprehensiveness.

Structural Policy Changes:

- Restructuring, reform and privatization of the banking and financial sector, promoting competition.
- Tariff reduction, removal of non-tariff barriers, deregulation of imports, end of the monopoly of government purchases of POL, the rationalization of tariffs.
- Separation of regulatory functions from policy making and setting up of independent regulatory agencies.
- Tax reforms including self assessment of income tax and the reduction in tax rate on banks.

Property Right Arrangements:

- Privatization of public sector enterprises including banks.
- Sale of shares to public through stock exchanges.

Pricing Policies:

- Removal of subsidies and administered prices on agriculture commodities and lifting of restrictions on agriculture exports and imports.
- Output and input marketing in the hands of the private sector.
- Decontrol of essential prices that are determined by market forces.

³ For detailed analysis of each set of Reforms, please see Ishrat Husain, Economic Management in Pakistan 1999-2002 (Oxford University Press 2003)

- Prices of petroleum products deregulated and aligned with international prices, changing every fortnight.

Governance Reforms:

1. Accountability bureau to combat corruption.
2. Devolution of powers to local governments to enable delivery of basic services to the poor.
3. Fiscal transparency, accounting and auditing separation, new system of financial controls and budgets.
4. Transparency in government procurement.

I will take up, for the sake of illustration only, two of these reforms – Trade Liberalization and Financial Sector Reforms.

Trade reforms have brought about a significant reduction in tariff rates and removed non-tariff barriers. The maximum tariff rate which was 125 percent until 1990-91, was reduced to 25 percent by 2002-03 while average effective rate is down from 30 percent to 9.8 percent. Contrary to the critics of these reforms, trade liberalization has not adversely affected the Balance of Payments situation. In contrast, tariff reduction along with free floating market determined exchange rate, complete convertibility of current account transactions and partial opening of capital account, have not only increased trade but also imparted significant strength to the balance of payments. For the last four years consecutively, the country has recorded current account surplus and had an overall positive balance. Accumulation of foreign reserves has consequently risen from 4 weeks

of imports in June 2000 to 40 weeks of imports in June 2004. Accessibility to imports has had a positive impact on the growth performance.

Pakistan's export performance during 1995-2000 was dismal – almost 1 percent growth compared to the average growth rate of 11% seen in developing countries. On the contrary, Pakistan's export growth during the 2001-2004 period kept pace with that of the average seen in developing countries. Not only was export growth more rapid, import growth was also impressive. Trade reforms of 2000 have started to yield positive results and positioned Pakistan well to face the post 2005 global trade challenges.

<u>Growth Rate</u>	<u>1995-2000</u>	<u>2000-2004</u>
World Exports	7%	7.1%
World Imports	9%	7.2%
Developing Countries' Exports	11%	10.8%
Developing Countries' Imports	8.8%	10.3%
Pakistan's Exports	1.0%	10.2%
Pakistan's Imports	-0.2%	13.3%

Source: WTO, UNCTAD, SBP

Financial sector reforms which were initiated in the early 1990s, had some hiccups until 1997 and were intensified after 2000. The results speak for themselves.

The financial system of Pakistan has been adjudged by a recent Financial Sector Assessment Mission of the World Bank and the IMF⁴ to be sound and healthy and quite capable of withstanding exogenous shocks to the system.

The system is built upon the pillars of private sector managed and owned financial institutions operating in a competitive environment but overseen and supervised by a strong regulator. 80 percent of banking assets today are in the

⁴ IMF, Pakistan: Financial System Stability Assessment – Country Report No. 4/215 (Washington D.C., July 22, 2004)

hands of the private sector – a rare feat for a developing country. The central bank is independent, competent and acting as a strong watchdog while bank profitability is at the highest levels we have seen in decades. Capital position of the banks is very strong, significantly above the regulatory standards. Asset quality remains robust and net NPL ratio is below 5 percent – the acceptable international norm. Interest rate spreads have declined from 7.5 percent to 3.5 percent during the last five years. The financial markets are pricing risks of financial institutions at very favourable levels with bank equity prices, subordinated debt spreads, suggesting a high degree of investor confidence.

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 the Pakistani economy has survived four serious challenges 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 borders intensified the tension with our neighbor and the terrorist killings in Karachi and elsewhere painted a grim picture of the country the world over. Despite these adverse shocks, the Pakistani economy has recorded growth rates of over 5 percent, with low inflation, registered a surplus external account, maintained a stable exchange rate, and attained low interest rates with hardly any speculative attacks on currency or equity markets.

Sustainability of Reforms:

Why should any one believe that the same stability and orderly conduct could be expected in the future? After all, there have been serious reversals in the recent past i.e. after a very impressive start in 1991, the rest of the decade of the 1990's witnessed the Pakistani rupee 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 policies has huge political costs.

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 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 any future leadership taking steps to nationalize banks or undo the privatization process. Every single major political party in Pakistan is committed to the idea of privatization and has done so in actual practice when in power.

Another example is the oil and gas sector. The mandate of the Ministry of Petroleum and Natural Resources has been curtailed to policy making responsibilities while a quasi-judicial and 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 is it 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 old habits die

hard 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 the PTCL monopoly and the deregulation of the telecom sector, the unbundling of WAPDA and the 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 in this direction in the future. Although cultural change and change in mind set will take some time, 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. The Central Board of Revenue (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. The tax payer will file his own assessment of income tax and only 20 percent of the returns will be scrutinized by audit. The same system is being applied for collection of other major taxes. Technology is being used to simplify the processes. Thus the extortion, harassment, under the table payments and wheeling dealing will all come to an end under this system.

The government's own lack of fiscal discipline has been one of the major contributory factors to Pakistan's indebtedness. A Fiscal Responsibility Law has been approved by the parliament and this law will put a statutory limit on fiscal deficit and public debt. Hopefully this restraint on government's spending will ensure that fiscal discipline remains in place.

Pakistan has made commitments 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 any 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 2002 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, despite several changes in the office of the prime minister. 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, sequencing 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?

Despite the improved prospects for the sustainability of the reforms, I would be less than honest if I do not point out the risks that can derail these reforms.

First, it is assumed above that the country will continue to face a benign external environment and will remain free from major upheavals and unanticipated exogenous shocks. In case the external environment becomes hostile or some other major internal disturbance takes place, it is unlikely that the reforms will proceed along the lines pointed out above.

Second, the implementation capacity and weakness of institutions have become major obstacles. There is a need to inculcate professionalism, expertise, competence and systems to make the civil services meet the realities of the 21st century. The nature of the government has dramatically changed, public expectations have heightened while implementation capacity of government policies, programs and projects as well as the delivery of public services has been seriously impaired. Poor governance, inertia, inaction and lack of knowledge have spawned a culture in which wasteful expenditures, leakages of resources and low efficiency are nurtured. Sound policies cannot see the light of day until the institutional capacity is strengthened and reoriented. Public-private-community partnership provides a way forward to mitigate this risk. The reform of civil service is on the agenda but needs to be expedited.

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 have to be given priority attention by political leaders. The Asian Development Bank (ADB) is assisting the government through its Access to Justice programme.

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 class of consumer will have larger disposable income if their household expenditure in energy is curtailed. The sooner the KESC and the distribution companies of WAPDA are privatized the better off the economy will be. Investment in key infrastructure such as power generation, oil and gas, ports, etc. would require public-private sector collaboration.

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

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.

TABLE – I

Net External Transfers Received by Pakistan

(all Official Grants and Loans included)

		<u>\$ in Million</u>	
		<u>Annual Average</u>	
Bhutto Period	FY 1971 – 77	2942	490
Zia Period	FY 1977 – 88	6118	556
Democratic Regimes	FY 1988 – 99	8307	755
Musharraf Period	FY2000 – 04	-1008	-202

Source: Economic Survey of Pakistan

SBP Annual Reports

Note: External transfers include disbursements of all official grants and loans minus principal and interest paid on official loans (Public and Public guaranteed and IMF).

TABLE – II**Macroeconomic Indicators before September 11, 2001**

	FY 98-99	FY 00-01
Large Scale Manufacturing growth rate (percentage)	3.6	11.0
Inflation rate	5.7	4.4
Exports (\$ billion)	7.8	9.2
% of GDP	12.8	15.0
Liquid foreign exchange reserves (\$ million) End-of-the-period	1,730	3,212
Budgetary Deficit (as % of GDP)	6.1	5.3
Current account balance (as % of GDP)	-3.8	0.6
Debt Servicing paid (\$ million)	2,657	8,857
Tax revenues (Rs billion) End-of-the-period	308	392
External Debt/Foreign Exchange Earnings	335	259
Public Debt Servicing/Public Revenues	64	57

Source: SBP Annual Reports

TABLE III

Assets of Listed Military Owned and related Companies – 2002

	<u>Rs. In Billion</u>
<u>Non-Financial:</u>	
Total Assets of non-financial listed companies	1,069.97
Assets of Military owned and related companies	59.19
Share of Military companies in total assets	5.53%
<u>Financial:</u>	
Total assets of financial listed companies	2,907.16
Assets of Military owned and related companies	84.06
Share of Military companies in total assets	2.89%
<u>All Sectors:</u>	
Total assets of all listed companies	3,977.13
Assets of Military owned and related companies	143.25
Share of Military companies in total assets	3.60%

Source: Karachi Stock Exchange