PAKISTAN'S ECONOMIC ACHIEVEMENTS, PROSPECTS and CHALLENGES

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During the last five years, Pakistan has traversed the road from a difficult default situation on its external payments to a vigilant program under the International Monetary Fund and finally re-established access to international capital markets. GDP growth rate has exceeded 6 percent, inflation had remained under control for four out of five years, fiscal deficit has been reduced significantly, public debt ratios have declined, external debt burden has been lowered, exchange rate has remained stable, exports have almost doubled, tax revenues are recording double digit growth, interest rates had never been at such low levels in the history, remittances of Pakistanis overseas have multiplied by a factor of four, foreign exchange reserves have expanded twelve times from their 1999 level and unemployment is on a downward slide.

Can these impressive achievements be sustained and not reversed with the change in political regime? What has happened to the Pakistani economy that is different from the past this time

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around? I would submit that there are at least eight factors that have contributed to the sustainability and will make the difference:

1) There is a wide recognition in Pakistan now that prudent macroeconomic management and sound fiscal and monetary policies are pre-requisites for achieving high growth rates and maintaining stability in the markets.
2) Continuity, consistency, predictability and transparency in economic policies have a better pay-off in terms of restoring the confidence of investors in particular and economic actors in general.
3) Structural reforms such as privatization, deregulation and liberalization are critical for attaining macroeconomic stability and economic growth. In Pakistan, all the political parties are not only agreed upon this agenda but have implemented these reforms. It should be recalled that it was the Nawaz Sharif Government which introduced these reforms in 1991 that subsequently were pursued by the Benazir Government when it came to power. The same policies

have been implemented with vigor in the last five years.

4) A number of checks and balances have been built in the system that will minimize the risk of slippages and reversal and ensure prudence and faithful implementation of the reform agenda. These are:

    (i) Fiscal responsibility and Debt Limitation Law which puts limits on fiscal deficits and thus ensures fiscal discipline.

    (ii) Independence of the Central Bank and separation of regulatory agencies from policy-making.

    (iii) A fierce and independent media that acts as a watchdog on wrongdoings and corruption.

    (iv) Emergence of stronger civil society organizations which reinforce the role played by the media.

5) There has been a shift in the structure of production, distribution and trade from the public sector owned, managed and controlled enterprises to private sector

firms and entities. Competition among the firms and the markets will promote efficiency in the resource use and require lower inputs per unit of output enhancing the overall productivity in the economy.

6) Allocation of Capital – an important factor of production – through private banks, financial institutions and Capital Markets will be more efficient than the politically-motivated loans granted by the nationalized commercial banks. The restructured financial sector has also extended its outreach to provide broader access to the middle income and lower income groups and underserved sectors such as agriculture and SMEs.

7) The quality of governance has improved at least at the top and the impending reforms should be able to remove excessive discretionary powers employed by the lower functionaries in the bureaucracy. For example, the introduction of Universal Self Assessment Scheme has eliminated the discretionary powers of income tax collectors. The use of technology

and business process re-engineering should further reinforce this tendency.

8) Globalization, financial market integration and access to global capital markets will force the governments towards continued good behavior and performance as the markets can penalize the countries indulging in infractions instantaneously and heavily. The market discipline will act as a brake upon the egregious behavior of the Government.

What are the possible areas of concern or risks to the future sustainability of the growth path and towards achieving the Millennium Development Goals set by Pakistan, the most important being the reduction in poverty by one half? I can identify at least seven challenges that the country has to deal with in the coming years which can otherwise derail the journey:

(a) There should be no major shift in the direction of economic policies and the quality of economic management that have been followed so far. The year 2007 is the test case for establishing the seriousness and credibility of Pakistan's economic program. Should the newly-elected political regime continue to move in the same direction, of course with some changes suited to the circumstances, Pakistan would be perceived in the same vein such as China and India. China has been following the same economic path set by Deng Xiaoping in 1980 with modifications and adaptations to the changing external and internal condition – despite changed political leadership. India, which started its reform process under the Congress in 1991, was finally accepted as a credible reformer only after the BJP Government forcefully and vigorously moved on the same path since 1996.

(b) The external environment remains favorable. The present oil price hike has created serious pressures on the current account balances and it is essential for an oil-importing country such as ours to see some moderation in the prices of oil. The other burning issue is the increased market access to Pakistan's textile exports to the U.S. and the EU. The tariff discrimination and anti-dumping duties against Pakistan's exports have tilted the playing field against us. The developed countries can assist Pakistan not by increasing the burden on their taxpayers in the form of aid but by reducing the prices of apparels and textiles for their own consumers in the form of enlarged market access.

(c) Pakistan has been a laggard in human resource development for quite some time. The "All hands on-the-deck" approach in which the Government, private sector, non-governmental organizations, charities, communities and philanthropists combine their efforts to effectively deliver education, health, drinking water to the poor towns and villages at affordable prices will work. The Government has an obligation to finance the education of the lower income groups but it is not necessary that they should be the providers also. Only those who are efficient and effective and can reach out to the poor communities should be encouraged to provide these services financed partly or wholly by the

Government. Technical and vocational education should be given priority to produce the skills that are required by the economy while minimizing the unemployment among the educated youth.

(d) Higher growth rates for an extended period of time in the range of 7 to 8 percent annually are possible only if energy, water resources and infrastructure needs are fully met. Otherwise, shortages, congestions, and bottlenecks will slow down the growth process. Government's budget can absorb only one half of these requirements in a non-inflationary environment. The other half has to be raised through public-private partnerships with recourse to capital markets. Innovative ways of financing have to be explored for this partnership to take off and produce results.

(e) One of the most interesting experiments initiated in Pakistan in 2000 was devolution of administrative and financial powers to the local governments. This experiment has run into some snags since the elections and a stable equilibrium between the provincial and local governments has not been found as yet. But there is no doubt that for bringing about demand-driven balanced regional development and delivering basic services to the vast majority of the poor, there is no better vehicle than the district, tehsil and union-level governments. The sooner the problems facing this transition are resolved, the greater will be the impact on development of backward areas and the services to the poor.

(f) Growth alone will not suffice to reduce the incidence of poverty. It has to be accompanied by poverty-targeted interventions and social safety nets. The Khushal Pakistan program initiated by the Musharraf Government in 2000 was a success in building minor but essential infrastructure projects at the local level and creating employment opportunities. Zakat, Baitul Mal, and Food Stamps are some other programs that can distribute the benefits of growth to the vulnerable and disadvantaged segments of the population. These programs need to be revamped and revitalized in order to become effective social safety nets for the poor.

(g) Pakistan's export base is still quite narrow and highly concentrated. Cotton textiles account for two-thirds of total exports. Dynamic export, products that are all dependent on medium and high technology are conspicuous by their absence. In order to maximize the benefits from globalization and buoyant world trade, we have to gradually build up our capacity to produce medium and hi-tech exports. This will not only diversify the base but also insulate us from fluctuations and volatility in cotton and textile output and trade.

(h) Even if all the above mentioned challenges are successfully tackled, the economy and the people, particularly the poor, will not be able to derive full benefits unless our institutions are restructured and their capacity strengthened. Civil Service, Judiciary and Police are the key institutions that affect a common man's daily life. Regulatory impediments are still hampering new businesses. Reforms of these

> institutions have to be put on top of the agenda and pursued relentlessly. The Thana-Kutchery Tehsil nexus that has remained intact since the colonial days has instilled a sense of fear and insecurity in the minds of the poor and unconnected and locked in their initiative and drive so critical for any growing economy. The unleashing of their energies in a more supportive institutional environment will do a lot of good to higher growth and poverty-reduction goals.

In the short term, however, we are grappling with the problem of inflation. After four years of low inflation rate below 4 percent, the rise in aggregate demand arising from rising per capita incomes, the monetary expansion policy pursued since 2001, the oil price spike and the food shortages have all combined to intensify inflationary expectations in this fiscal year. The State Bank is already tightening the monetary policy and raising interest rates. A bumper wheat crop is expected this year and oil prices are beginning to slide downward. These factors should be able to dampen inflationary expectations in the coming months.

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