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Inaugural Address

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Syed Nawab Haider Naqvi, Dr Ghaffar Chaudhry, Distinguished Guests, Ladies and Gentlemen:

It is my privilege to inaugurate the Fifth Annual General Meeting of the Pakistan Society of Development Economists.

During the past six years of its existence the Society, which I founded in 1982, has become an institution devoted to the pursuit of scientific virtuosity and academic rectitude. It has provided a powerful medium through which a serious discussion of economic and demographic issues related to Pakistan's economy has become possible. I am happy to know that by this time over one hundred papers, written by scholars from all over the world, have been presented in this forum. In addition, the Inaugural Address, the Presidential Address, the Quaid-i-Azam Lectures, and the Guest Lectures, presented in this forum each year, provide a synoptic review of the fields of development economics and demography, and of issues relating to the economics of education, health and the role of women in the development process. This massive intellectual output should strengthen the process of knowledge creation by matching the theories of economic development with the 'reality' in the developing countries. The resulting literature, with a focus on Pakistan, also provides rich source material and guidelines for policy formulation in the field of socio-economic development. I must add, however, that while due to the contributions of the Society we know much more about the nature of the development problem, our knowledge of how to solve it has probably not expanded as much.

The Fifth Annual General Meeting is being held at a difficult time in our economic history when far-reaching decisions must be taken. We face a difficult international environment, and an even more demanding internal challenge of creating a dynamic, just and efficient economy based on Islamic principles. But let me first review the international economic situation to put the debate about Pakistan's economy in a wider and proper context.

The international economic environment has been characterized in the Eighties by economic recession, high interest rates, exchange-rate volatility, persistent payments imbalances, money-market instability, high rates of unemployment and a

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rising protectionist sentiment in the developed countries. Thanks to the rise of protectionist sentiment in the West, the growth of world trade has also been slow and is accompanied by falling commodity prices, resulting in a sharp deterioration in the terms of trade of developing countries.

The international response to the structural imbalances in the world economy has so far been inadequate and disjointed. Even though there is a consensus about the need to harmonize domestic fiscal and monetary policies, the macro-economic policies of the industrialized countries remain divergent. A solution has still to be found to the persistent U.S. budgetary and balance-of-payments deficits and the corresponding surpluses of Japan, West Germany and the newly industrializing countries.

As a result of these developments, fiscal and current account imbalances of the developing countries have steadily worsened while real interest-rates have increased, swelling the cost of the new and existing debt. Despite the start of the Uruguay Round of GATT talks, there seems to be little hope for an early relaxation of protectionism in the West, particularly of agricultural commodities which, because of their preponderance in the export of developing countries, is hurting them even more than Western protection of manufactured goods. Some recent studies show that protection in the North costs the South about twice as much as the developing countries receive in aid. To make matters worse, the net capital flows to developing countries have declined. In fact, resource transfers to developing countries have become negative, totalling US $ 85 billion since 1982. The declining availability of capital resources and the need for investment to take care of the requirements of their burgeoning populations have forced many a developing country into the private money market, where interest rates are high and repayment periods very short. As a result, the burden of debt on developing countries increased sevenfold in only 14 years. Currently, it amounts to a little over a trillion dollars, as compared with only US $ 140 billion in 1974.

The weakening of the impetus emanating from the developed countries and the growing incapacity of the developing countries to scale the debt mountain have prompted the call for a New International Economic Order (NIEO). It involves a new monetary system and a new world trading system to ensure the creation and distribution of world liquidity among different nations on an equitable basis and the maintenance of a 'just' price for the exports of developing countries. These battles have been fought and lost in the IMF and the GATT, mostly in the aftermath of the failure of the OPEC to control the world oil price in their favour. The battleground has since shifted to the developing countries, where attempts are being made to form regional groupings. Pakistan is also a member of two such groups – namely, the ECO and the SAARC. The danger is that in the absence of adequate and timely action to forge economic integration, these promising regional groups might wither on the vine.

In such a discouraging international environment, the performance of Pakistan's economy during the past many years has been reasonably satisfactory, both in absolute terms and relatively, among the developing countries. An average annual growth rate of GDP of 6.6 percent during the past decade, is an important economic 'event' by itself, given the many problems that Pakistan's economy has faced. This performance represents a certain quality of the economy that permits high growth rates despite the various internal and external shocks to which Pakistan has been subject during this period.

The high growth rates of GDP have been sustained by several factors. First, the agricultural sector has grown at 3.9 percent per annum, during the past ten years. The provision of infrastructure, extension of new technology, spread of high-yielding varieties of seed, and proper incentives to the farmers have all contributed to this growth. Second, the growth of manufacturing production during the period 1980 to 1986 was 9.3 percent per annum. This is an enviable performance by any standard; it is excelled among major developing countries by only South Korea and China. Third, since the early Sixties, the services sector has grown at a healthy rate of 6.8 percent per annum. The rise of the services sector, because of its labour-intensive character and lower capital requirements, has made it easier for the country to maintain a high growth rate.

But while talking of good performance in various sectors of the economy, we must be realistic to admit that growth rates do not always tell the whole story. At least, they do not necessarily capture the standard and quality of life, improvement of which is, in the final analysis, the end objective of all developmental activity. If we look at indicators like nutrition levels, health standards and education, we do see improvements but not such as correspond to our rates of growth. Similarly, we still have to attain such levels and norms of productivity, in different occupations and in our technological capability to produce different products with reasonable efficiency, as can make development a durable and self-propelling process. Our not-so-happy performance in this regard is due mainly to the micro weaknesses which persist in our economy despite its macro dynamism.

I would like here to give you a few examples of the outstanding issues. Much of the growth of the agricultural sector has been secured through Government support of both inputs and outputs. The cost of agricultural output is high. Efficiency of use and productivity of agricultural inputs is sub-optimal, and yields per acre are abysmally low even by developing-country standards. In the industrial sector, the expansion of the productive base has been achieved behind high tariff walls and the quality of output leaves much to be desired. The technology used is low-grade and uncompetitive, while the employment potential of this sector has been declining for some time. Skill formation, so vital for introducing new and competitive technologies, is inadequate. The level of investment has also not shown much improvement over time. The national saving rate is only about 13.3 percent of GDP, which is at best moderate. One may also bemoan the severe problems we are facing in mobilizing domestic resources through taxation to finance economic growth. The increasing instability of our trade sector is another problem area which causes considerable anxiety. And to top them all, poverty remains rampant despite an impressive growth rate.

This is why some quarters find it hard to accept that Pakistan's growth is genuine. To them, perhaps economic growth is real only when generated through massive investments in heavy industries. We may not agree with them. But the fact that in the long run Pakistan must raise its saving rate to finance a high rate of investment in certain key sectors of the economy is a legitimate concern.

We all are aware that the present level of resource generation in the public sector is inadequate. We pay a very small proportion of our income by way of tax. And a large share of what is, in fact, paid is by the low-income groups through indirect taxation. Direct taxes constituted only 1.9 percent of GDP in 1987-88. Overall tax revenue, excluding surcharges on gas and petroleum, as a percentage of GDP, has declined steadily over time to 11.7 percent in 1987-88. While tax receipts have not risen fast enough, non-development expenditure on debt-servicing, defence and administration has increased, largely for understandable reasons, at a rate faster than the growth rate of GDP. As a result, the overall deficit in the government budget during the past five years has averaged 7.5 percent of the GDP, while the outstanding internal debt liability has grown by almost five times during the last eight years. At the same time, the country's external debt has increased steadily over time and debt-service charges as a percentage of total exports are now 17.5 percent, which is a cause for concern, particularly when account is taken of the fact that the proportion of short-maturity loans in the debt portfolio has also risen.

In the social sectors, again, progress has not been commensurate with the rising demand of the people for more public services. Since 1986-87, only around 3 percent of GNP has been spent on the development of social sectors. Pakistan's annual expenditure on education for the past decade has been a meagre 1.8 percent of the GNP. In this sector much more remains to be done. A literacy rate of 30 percent, with a large section of the population having a literacy level of only middle or less than middle-level education, continues to be a serious weakness of the economy.

Similarly, investment in the health sector has been lagging behind. The total expenditure on health in the year 1987 was less than 1 percent of GNP. As a direct consequence of the lack of proper health facilities, particularly in the rural areas, the infant mortality rate still remains high even though life expectancy at birth is now 61 years as compared with only around 40 years at the time of Independence. As in the field of education, a lot remains to be done in the health sector also. Attention needs to be paid in particular to the rural areas in order to remove the urban bias in the present distribution of health facilities.

From what I have stated so far, it should be evident that, despite an excellent overall performance, the country is still faced with serious problems. Some of these problems arise from the international environment, which I have sketched earlier. To them, we should respond by participating more actively in the NIEO-related discussions about reforming the structure of world trade and monetary system. We should support initiating a fruitful dialogue for a new International Development Strategy; and endorse the proposal of the Group of 77 to convene in 1990 a special session of the United Nations to discuss ways and means of solving the problems of the developing countries. We should also look for regional collaboration, both in the framework of the SAARC and the ECO, to find a home for our agricultural and industrial exports.

But not all of our problems are "in our stars"; some of them lie in ourselves. It is these problems that we should seriously address.

I shall now briefly sketch my views about what needs to be done in the future. First, our central concern should be to safeguard our high growth rates and to watch the price line. With a population growing at a rate of 3 percent, the GDP growth rate must be kept about 7 percent per annum. We should also try to achieve a better income distribution, a lower level of absolute poverty, and higher employment and real wages. Among other things, a widespread adoption of efficient labour-intensive technology may help to achieve these objectives without raising capital-output ratios to unacceptable levels. The informal sector has shown, in recent years, a remarkable capacity to keep the unemployment problem within manageable limits, and we should exploit the growth-promoting and employment-generating potential of this sector further.

Second, we should increase further the production of cash crops, encourage farmers to adopt modern measures of sowing and harvesting, and ensure crop protection. To make sure that this happens, deliberate efforts will have to be made to move from a predominantly "resource-based" agriculture to "science-based" agriculture.

Third, we will have to accelerate further the growth momentum of our manufacturing sector, diversify its structure in favour of higher value-added industries, undertake technological upgradation of production processes, and, moving the sector away from simple import substitution, make it more efficient, competitive and responsive to the needs of the domestic and international markets. We will also have to revive the private investor's faith in the vitality of the manufacturing sector and encourage him to take risks and face uncertainties with courage and confidence.

Fourth, it is imperative to establish, as early as possible, a sustainable fiscal balance by intensifying resource mobilization efforts, increasing domestic savings, reducing the rate of growth of government expenditure, eliminating subsidies and lowering public-sector investment.

Indeed, to promote the twin objectives of efficiency and equity, four interrelated steps will need to be taken simultaneously: (i) the tax base must increase all-round to make it elastic; (ii) all wasteful incentives should be withdrawn; (iii) the share of direct taxes in total revenues must rise; and (iv) the tax structure must be made visibly progressive.

Fifth, much more effort is needed to reduce dependence on external debt and to prevent the balance-of-payments situation from deteriorating any further. Export expansion has been impressive but it has not been efficient in the realm of higher value-added items, particularly engineering goods, and in the exploitation of either our agro-industrial potential or new markets. We will have to work more seriously to diversify and widen our export base, while at the same time reducing our imports.

In order to realise the developmental objectives in the fields of industry and agriculture, it is also necessary to strengthen and expand the infrastructure. Priority attention will have to be given to the energy sector.

I must emphasise that the many social and economic problems that I have touched upon are difficult, but they are not insurmountable. They do, however, need a more imaginative response so that we can consolidate gains achieved so far and guide the equiliberating process in the right direction.

The aim of all economic development must be to build a humane and just society. It should serve to consolidate the values which the society holds dear and should create national harmony and solidarity on the basis of shared values. In our context, we should, therefore, seek solutions to these problems within the framework of an Islamic system to which our Constitution definitely and irrevocably commits us. Indeed, most of the problems I have referred to earlier – for example, the problems of an unequal distribution of income, inadequate resource mobilization, and extreme poverty – find a natural solution in the Islamic economic system, based on the Divine principles of *Adl* and *Ihsan.* This is a vast subject, but I will make a mention of a few aspects of the Islamic system.

First, in the Islamic perspective, man is seen as a "trustee", and not an absolute owner of what he owns, and in whose wealth there is a right acknowledged of the needy and the destitute. Similarly, the individual's right to private property and his freedom to enter or quit specific economic activities is also not absolute, but relative to the needs of the society.

Second, the revolutionary Islamic principle of *Infaq* requires, among other things, that a mechanism should exist for resource transfer to meet the collective obligations of the society and to redress the grossly uneven distribution of income and wealth. A consistent application of this principle will also lead to the creation of a comprehensive social security system to help the needy and the deprived. The Islamic principle of *Infaq* will also require that the fruits of economic progress be equitably distributed among the principal economic agents, including labour and capital.

Third, the Islamic injunction against *Tabzir* implies, among other things, that steps should be taken to curb wasteful consumption.

Fourth, the proposal to Islamize the financial sector – by eliminating interest-based policy instruments and replacing them by a system based on profit-and-loss sharing – has a clear economic rationale. The basic argument is that financial transactions must satisfy two requirements: (i) the lenders and the borrowers – also labour and capital – must get a fair share in total profits in a proportion that is mutually (voluntarily) agreed upon in advance; and (ii) this share must vary with the size of total profits – which can be positive, negative, or zero.

A number of important steps have already been taken in Pakistan, to 'Islamize' the economy. The system of *Zakat,* now operational in Pakistan, has the potential of being expanded and generalized into a powerful social security system for the poor and the needy in the society. Then, the financial sector of the domestic economy has been rid, at least to some extent, of *Riba* (interest). Instead, certain new financial instruments – e.g., the Participation Term Certificates (PTCs), the lending on *Musharakah* (partnership) basis, and the *Mudarabah* certificates – have been introduced. Such policy instruments, as they increase the efficiency and financial intermediation, may provide at least part of the answer to the need of increasing private savings and capital formation, and of ensuring their efficient use.

The time has now come to consolidate what has already been achieved and to widen the scope of Islamic reform. Steps must be taken to implement a wide-ranging action programme covering both the 'real' and the financial sectors of the economy. Even more important, the Islamization programme will have to be implemented as an integrated programme of social amelioration. It must address the problems that Pakistan at present faces – especially those relating to poverty, want and social degradation. Universal education, the generation of employment opportunities, and the creation of a comprehensive social security programme must all be seen as part of a meaningful Islamic policy package. What we must aim at is a grand realignment of the centres of economic power through a wide variety of policy instruments – to redress the economic imbalances existing in the society. It is only in this way that Islamic economic reform can serve as a vehicle of social change, and provide solutions to the current problems.

With these words, I inaugurate the Fifth Annual General Meeting of the Pakistan Society of Development Economists.

Pakistan Zindabad.