

Inaugural Address

SARDAR FAROOQ AHMED KHAN LEGHARI

Dr Sarfraz Khan Qureshi, Director of Pakistan Institute of Development Economics, Distinguished Guests, Ladies and Gentlemen,

It is a great pleasure for me to be present here this morning. Over the years, the Pakistan Society of Development Economists has made notable contributions to the profession of Economics and Planning. It has also helped to strengthen the evolution of scientific knowledge in Development Economics. More importantly, it has given an institutional shape to the exchange of ideas between economists, other social scientists, and policy-makers. I am happy to note that a large number of distinguished academics and policy-makers from all over the world regularly participate in the Society's meetings. I earnestly hope that useful policy prescriptions will emerge from the deliberations that take place here about the major issues in economy. Indeed, I wish to extend my appreciation to the Society for providing a lively and effective platform both to researchers and policy-makers.

The Twelfth Annual General Meeting of this Society is taking place at a time when a number of momentous changes are on the horizon. The end of the Cold War removed a great source of tension that had divided the world into ideologically opposed camps. This had opened up opportunities in quite a few countries to redirect resources towards economic development and other social objectives. The countries of our subcontinent must also share in the peace dividend and strive to find pragmatic solutions to the complex regional conflicts which continue to divert our scarce resources from the socio-economic development programmes.

Another event of historic significance is the successful negotiation and signing of the Uruguay Round (UR) Agreement. These changes bring daunting challenges alongside great opportunities. A good deal of research shows that about a third of the total gains likely to emanate from the new world trading environment will accrue to the developing countries worldwide. The question for us is: Are we ready to benefit from these opportunities in this part of the world?

The World Trade Organisation (WTO) now consciously seeks to promote a rule-based, multilateral, and non-discriminatory world trading system. Yet, ironically, there are indications that the market access available to the developing countries would not improve substantially. The non-tariff barriers have been treated in such a manner that the tariffs on items of interest to developing countries still remain high. The trade in

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agricultural products and textile products, in which lies our main concern, has only begun to be liberalised. Abuse of the anti-dumping laws and linkage of the environmental and labour standards with trade by the developed countries is unduly limiting the competitive abilities of the developing countries.

These apprehensions apart, let me state that we do not have any doubt about the long-term benefits that developing countries can potentially reap from the changing world trading environment. Our vision is clear. Although the multilateral agreement will impose some costs on our economy—as there is no change which is free of cost—yet there is a lot more for us to gain from the Agreement. It depends on how well we manage our economy. If we allocate resources in an optimal manner, then the gains can be substantial. Otherwise, the opportunities will be missed.

An interesting parallel development is the new wave of regionalism. Some observers have expressed doubts about the formation of regional blocs and their possible adverse effects on multilateralism. We consider regionalism as part of the outward-oriented trade strategies that members of a regional bloc can adopt. The UR Agreement has addressed liberalisation of trade in goods and services, while regionalism, additionally, addresses issues relating to the movement of capital, harmonisation of regulatory regimes, and coordination of domestic policies that favourably influence international competition.

I may also caution that this new era of opportunities in trade and investment will be neither easy nor smooth; it will pose its own difficulties. We shall have to learn quickly to adjust to the harsh new realities of the world. This will require that we produce appropriate goods of good quality and in right quantity; and we shall need to be innovative and efficient to keep our costs competitive. This is a multi-dimensional challenge of major proportions, and we must marshal the necessary resources to meet it.

Ladies and Gentlemen,

Before proceeding further, I would like to highlight some of the major structural weaknesses that are affecting Pakistan's economic performance. The first and foremost is the fiscal imbalance represented by the ever-growing gap between government revenue and government expenditures. High budget deficits are inflationary and have adverse effects on both export performance and the common man. In the past, corrective measures were not taken to reduce the high level of budget deficits. It is not surprising that Pakistan has been suffering on account of double digit inflationary pressures. The high rate of inflation has made our goods uncompetitive in the world, and brought much misery to the common man. The tearing apart of the social fabric can be attributable to a highly incapable finance policy.

The second structural weakness relates to the monetary system, particularly the nationalised banks and other financial institutions that have become a pawn in the hands of their political bosses. Loans are granted to those who wield political power and then

these are not repaid. This not only weakens the banking system but also dries up the funds available for productive investment. Similarly, the weaknesses in the monetary and financial systems impinge unfavourably on the level of domestic savings. In the South Asian context, Pakistanis save much less than Indians. Low saving rates adversely affect investment rates, which in turn affect the growth performance of the economy. Again, what little investment does take place has low rates of return on it.

The third major structural weakness is the high rate of internal and external debt. Domestic debt service payments are the single largest item in the budget. Similarly, repayment of external debt takes up a substantial portion of the meagre export earnings of the country. The previous governments had failed to evolve viable debt management policies to keep the national debt—both domestic and foreign—at a sustainable level.

Physical infrastructure, in the form of roads, railways, airports, canals, and power plants, plays an important role in the economic development of a country. In Pakistan much of the physical infrastructure has rapidly deteriorated and has severely constrained economic expansion.

Then there has been low human resource development. In Pakistan, the development of human capital is at a lower level than in other South Asian countries, which are already at a low level by world standards. For example, our literacy rate is the lowest in South Asia, and so is our spending on education and health. This, coupled with rapid population growth, low agricultural yields, low investment, etc., has all contributed to the re-emergence of the poverty phenomenon in recent years. The situation is made worse when government institutions responsible for the provision of basic services to the more disadvantaged segments of society are incapable of doing so. This causes a credibility gap and, in general, weakens such institutions.

Last but not the least are the troubles caused by an antiquated legal system which does not enjoy the confidence of the people. In a world where the interests of many competing groups have to be protected by an adequate legal system, our failure here has alienated people who would otherwise have willingly borne the heavier burden that the adjustment programmes always and inevitably imply in the short run.

Ladies and Gentlemen,

I have just mentioned the broad challenges facing Pakistan's economy. Now I would like to dwell on a few basic items which we need to deal with competently while managing our economy.

One of the most pressing social problems that we face is persistent poverty. Many analysts believe that the incidence of poverty is again on the rise. In any case, a large proportion of the population, amounting to a very large absolute number of people, remains poor. Inadequate nutrition, health, education, housing, and sanitation facilities are the principal forms of deprivation. The pervasive deprivation has been the result of insufficient economic development

and inequitable distribution of its benefits.

Another major problem which our country is facing is the high population growth. The growth rate of population remains high despite the fact that we have been committed to a population welfare programme for more than three decades. We are now dealing with a demographic profile where a small number of adults have to support a large number of dependents, including elderly dependents. A large number of countries of the world, including many muslim countries, have achieved much greater progress than what we have been able to achieve on the population front. The country's high population growth rate is a dangerous explosive to live with.

Notwithstanding some high points, overall economic growth has remained around 5 percent in the 1990s. With such a low rate, we cannot even achieve the standards of living in the ASEAN countries. Without a substantially higher growth, the goal of macroeconomic stability will remain elusive and the social problems will worsen.

Foreign direct investment has been an important factor in promoting economic growth worldwide. Despite the effort made, Pakistan has not been able sufficiently to take advantage of its potential for investments from abroad. To attract foreign investment, Pakistan seems to compare less favourably with the neighbouring countries in such matters as efficient communications, trained workforce, macroeconomic stability, and export bias. Also, satisfactory law and order and political stability are important ingredients of a business environment, and particularly to attract foreign investment. Without these pre-requisites, the economic incentives would not be effective.

For sound macroeconomic management, it is critical that we adopt policies that will fill the domestic resource gap and reduce the balance-of-payments deficit. The balance-of-payments problem is mainly due to our persistence with the import-substitution strategy, which has a built-in anti-export bias. Government's efforts to broaden the tax base and to improve tax administration have proved to be insufficient. Similarly, efforts to reorientate and increase the efficiency of public expenditure have had limited success. Fiscal deficits of the current magnitude do not seem to be consistent with Pakistan's development objectives. Lack of progress in this area will ultimately undermine the growth and anti-inflation objectives, as the large public sector borrowing requirements will continue to divert a vast amount of currently low and insufficient private financial savings, and/or draw heavily from the monetary system. In fact, the crucial factor behind our weak external position is the lax fiscal policy, which increases expectations of further depreciation of the rupee, and thus causes a host of other problems, including capital flight.

In the area of current expenditure, one of the main challenges is to ensure that debt-servicing does not crowd out the expenditures vital for economic growth; and that non-development expenditures will decline to meet all the outstanding development needs. By reducing the overall fiscal deficit, the government would set in motion a favourable process that would lead to smaller interest payments in the future, thereby providing a scope for expanding the development expenditure.

Another issue is the need to increase expenditures in the operation and maintenance of roads, railways, irrigation, water supply and sanitation, and basic social services. Measures are also required to reduce administrative inefficiencies and over-staffing at the lower levels of government employment.

The inefficient and unhealthy condition of the financial sector is imposing heavy costs on the economy and is adversely affecting the growth process. The main reason for this condition is that, being largely in the public sector, its default rate on the bank loan is very high. The crushing—and ever-increasing—burden of non-performing assets has already shaken the very foundations of a once robust financial system. Consequently, it cannot even meet the most urgent needs of the private sector. And there are too many explicit and implicit taxes in the financial sector, which constrains the banking sector's role as a financial intermediary. The resulting fall in both domestic savings and investment thus forces the economy to rely heavily on foreign savings and investment.

Improved public sector resource management policies need to be complemented by further progress on the private sector agenda. The positive response by the private sector to the government's recent structural initiatives underscores the importance of moving on to the next phase of policy change. The current debt burden is difficult to manage and is eating into future earnings at an unsustainable rate. A major issue in this area is that the term profile of external debt has seriously deteriorated as a result of massive short-term borrowings from commercial banks at high rates of interest. At the same time, the burden of internal debt has grown heavier, even at a faster rate than that of the external debt.

Economic decisions affect the environment and the quality of environment affects the performance of the economy. The sustainability of economic development is made possible only within this inter-relationship. We know that this is often not well-understood. Consequently, relatively high effluent-emitting industries are established without much attention paid to the treatment of industrial waste. Urban waste is being produced in a large quantity without any proper arrangements for its disposal. Similarly, mismanagement of water resources has resulted in the incidence of waterlogging, salinity, and desertification. Despite the awareness in this regard, it appears that very little

has been done to bring the economic motive closer to environmental safety and continuity.

Another reason for slow development in Pakistan is that the structure of governance suffers from excessive centralisation; bureaucratic inefficiency and corruption; imbalances of regions, gender, groups, and classes; and inequality of opportunity for jobs and access to health and education.

Let me emphatically state that a clear recognition of these challenges is just the first step. A speedy and powerful movement towards the formulation of an action plan is the next urgent step, which we must take now.

Ladies and Gentlemen,

Let me turn to the agenda for policy reforms which, I am sure, will benefit from your critical review and consideration.

To qualify as a middle-income country, we must try to achieve a growth rate of agriculture of above 5 percent per annum—not only by raising total factor productivity in the crop sector but also by activating the unexplored non-crop sector through appropriate policy measures. In the manufacturing sector, we should concentrate on both inter- and intra-industry diversification of production, especially in labour-intensive export-oriented industries, making industries competitive and meeting the standards set by the international consumers. Besides, efforts need to be made to increase the rate of total investment in the manufacturing sector and to increase the efficiency of investment by raising the total factor productivity through appropriate technological change. To increase domestic investment and savings, the financial sector must be efficient and healthy. This would reduce our heavy dependence on foreign savings and investment. It can be achieved by increasing the role of the financial sector as an efficient intermediary, and would require rehabilitation, deregulation, and privatisation of the financial sector, drastically reducing bad loans and adopting a fair procedure to recover the arrears while improving efficiency.

In order to attract foreign investment, appropriate measures should be taken to improve the investment climate in the country. These measures should include large national savings and investment, streamlining of administrative procedures to remove *ad-hocism* and to effect institutional reforms, reinforcing macroeconomic stability, accelerating the trade reform programme, and ensuring political stability while eradicating corruption.

For maintaining macroeconomic stability, it is essential to reduce both the budgetary deficit and the balance-of-payments deficit. The budgetary deficit

should be reduced gradually by expanding the tax base so that the tax-GDP ratio rises steadily over time. This, in turn, would require raising the share of the direct taxes in the total tax revenue and shifting the emphasis from the trade-based taxes to the generalised consumption-based taxes. Also, a comprehensive agriculture tax is necessary to make the taxation system both equitable and efficient. We have been living beyond our means, and have been doing so for too long. This must stop. A critical, zero-based review of expenditure is essential to eliminate wasteful expenses in the public sector departments and corporations. The government needs to restore a reasonable fiscal balance by increasing the revenues and rationalising the expenditures, i.e., the collection of revenues on an efficient basis and the raising of adequate revenues to meet the most legitimate expenditure needs. The current account balance-of-payments deficit has more than quadrupled over the last ten years and should primarily be reduced by strengthening the export effort; but effort should also be made to reduce the import bill, attract foreign direct investment, and encourage more remittances from abroad. The reforms of the trade regime should be carried out in conjunction with prudent fiscal management, since the former may imply a revenue loss. Sound macroeconomic management would also permit the government to strengthen international competitiveness while reducing expectations of a further depreciation of the rupee. The latter would help to increase the attractiveness of investments in the country.

I urge the policy-makers and researchers to look into both the productive and the reproductive behaviour of the economic agents in an integrated framework, where the level of economic activity is determined jointly with the size of family. I must underline that a high rate of fertility and a low rate of mortality cannot coexist in the long run. It would be essential to reduce the fertility rate for the success, in the shortest period of time, of other known social and economic indicators of progress like universal health-care and universal literacy.

The private sector is widely acknowledged as a key instrument for achieving economic goals in a world of rapidly increasing global competition. In our country, the private sector's development is seriously constrained by: (a) politically confrontational forces, (b) weak law and order apparatus that does not provide sufficient security to the life and property of the common person, (c) inadequate, inefficient, and expensive infrastructure for energy needs, telecommunications, transportation, and port facilities, and (d) large fiscal deficits which continue to deflect huge amounts of resources for the use of the public sector, crowding-out the private sector's urgent needs. Thus, there is a need to put an emphasis on policy reforms which are either directly or indirectly designed to encourage the development of the private sector and to enhance its

role in economic activities. The success of the private sector rests on the continuity of policies and the stability of macroeconomic fundamentals, which in themselves must be credible, consistent, and transparent. As the Ninth Five-Year Plan is now being formulated by the Planning Commission, I would urge the Commission to prepare a policy framework wherein growing participation of the private sector is ensured, while the role of the public sector is redirected and concentrated on providing a stable policy and regulatory environment—only complementing the private sector activity and investment in those areas where the public sector has a comparative advantage. Finally, we must work to achieve a small, clean, efficient and corruption-free government so that the private sector can flourish.

To alleviate extreme poverty, especially in the rural areas, direct income transfers may become necessary in addition to a greater provision of staple food items and other wage goods. Furthermore, incentive strategies should be attempted to enlist voluntary participation of the people in the production process.

For the sustained growth of the economy, it is essential to develop the social sectors. Thus, improvement in the delivery of basic social services is critical to ensuring the long-run sustainability of the government's development efforts both from an economic and a political point of view. Our adult literacy rate, female literacy rate, gross enrolment ratios at all levels, and the general education index are dismally low and disappointing. A better educated and healthier workforce is a pre-requisite for raising the productivity of the economy. At the same time, if basic living conditions of the population at large do not improve, any adjustment programme may be perceived as benefiting only the more privileged members of the society, hence undermining its political sustainability. Therefore, I urge the planners and policy-makers to extend the policy of investment in people beyond the next five-year plan. As such, the Social Action Programme (SAP) should be redesigned to meet the growing needs of the market economy. And inefficiencies of the SAP must be removed to enhance the effectiveness of the activities in these programmes.

I have mentioned earlier that there is, still, a poor understanding of the inter-relationship of the quality of environment and the performance of the economy. This is mainly due to the fact that the maximisation of growth has for long been the primary objective of our planning. This inter-relationship can be better understood in the perspective of economic development rather than economic growth. I must emphasise that the maximisation of growth without any consideration for the environment may not be sustainable over the long run; and, as such, short-run gains can only be derived at a rather heavy cost in the

long run. Therefore, sustained development, aimed at maximising growth and the quality of environment in a dynamic context, should be our first-best option. Finally, and most importantly, unless we correct our way of governance, it will be hard to sustain the level of development that we have achieved so far. For sustainable development, as I have said before, we must curtail centralisation; check the inefficiency and bureaucratic and political corruption; correct the imbalances of regions, gender, groups, and classes; ensure equality of opportunity through merit and transparent access to education, health-care, and employment; and we must mitigate the culture of collusion operating in such areas as default of loans, tax evasion, and conspicuous consumption, which have become addictions as dangerous as drug crime.

Ladies and Gentlemen,

The agenda I have just outlined is necessary for our economic health, development, and sustainability. If we act on it now, we can move towards recovery and good health. This will also help Pakistan to enter the 21st Century as a progressive, prosperous, modern, and democratic country in the world.

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

Thank you very much.

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