

The Inaugural Address

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Excellencies, Ladies and Gentlemen:

The 17th Annual General Meeting of the Pakistan Society of Development Economists (PSDE) is taking place at a critical juncture of our economic history. The events of September 11 have changed the complexion of the global economy. Global economic prospects appear grim, at least, in the short-run. Developed and developing countries are witnessing their economic growth reduced or even turned negative owing to the slowdown in the global economy. Growth in international trade during 2001 may undergo one of the severest deceleration in modern times. As 2001 closed and a new year began some two weeks ago, the global economy is now balanced precariously between recession and recovery. Although the full impact of September 11 events is still to be realised and evaluated, it has nevertheless, unleashed new and unpredictable forces that have substantially raised the risk of global downturn. Being the part of the global economy and that it has placed itself at the epicentre of global events, Pakistan has once again been thrust into the role of a front line state. Whatever happens to the global economy is bound to create temporary difficulties for Pakistan's economy as well. But at the same time, Pakistan is also witnessing the openings of several opportunities to strengthen its economy. The challenge before us is two fold: how to minimise the loss caused by the temporary difficulties and how to position ourselves to translate the openings of opportunities into real gains for the country.

Ladies and Gentlemen:

Two years ago in this very room, at the 15th Annual Conference of the Pakistan Society of Development Economists I shared with you a broad approach towards economic reform. This included among others:

- (i) reduction in fiscal deficit and containment of non-development expenditures;
- (ii) accelerating economic activity and stabilising stock market thereby raising prospects of profits and savings in the corporate sector;
- (iii) taking specific steps for promoting household savings;

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- (iv) ensuring economic and exchange rate stability to encourage home remittances;
- (v) accelerating economic growth and take such actions as would induce the people to save a major share of their incremental income;
- (vi) restructuring public sector enterprises to improve their financial position; and
- (vii) improve the incentive package for attracting foreign direct investment and investment by overseas Pakistanis.

Let me share with you what we have done since then. Pakistan's economy has made significant progress in the last two years. We have seen Pakistan successfully restoring relations with the international community, acquiring high credibility for its reform programme, harnessing important resources at home and abroad, successfully completing the IMF Standby Arrangement—the first in many programmes with the IMF, and putting into motion a broad participative process toward the revival of the economy. Given the difficult past that Pakistan's macroeconomic environment had reached by the end of the last decade, our government pursued a combination of stabilisation and structural reform programmes during the last two years. These policies have paid dividends as Pakistan stands economically stronger today to withstand the crisis emanating for the event of September 11. Sharp reduction in fiscal and current account deficits, an impressive recovery in industrial production, reasonable increase in tax collection, low inflation, sharp increase in credit to private sector, a modest growth in exports, sharp increase in remittances and impressive build up of foreign exchange reserves have been major successes of our government over the last two years. These improvements must be viewed with the backdrop of economic situation that our government inherited some two years ago. We inherited a weak economy. Declining economic growth, stagnant exports, falling revenues, growing debt burden, rising poverty, poor state of social indicators, and above all, deterioration in government had been the key features of the inherited economy. Slower economic growth along with deterioration in governance accentuated macroeconomic instability and contributed to the rise in poverty. Almost one-third of the country's population lives below the poverty line. The health of social indicators leave a lot to be desired.

Ladies and Gentlemen:

How to restore macroeconomic stability, and at the same time revive the sagging economy, in the midst of almost zero credibility with international financial institutions were the main challenges for our government. In order to address these difficulties our government pursued a two-pronged strategy. First, to restore macroeconomic stability, a credible stabilisation policy was thought to be absolutely vital. Second, we realised that Pakistan's economic problems were structural in

nature and the objectives of sustaining high growth, low inflation, and external payments viability cannot be achieved without removing structural bottlenecks. It is with this in view that we launched a series of structural reform measures that include: tax reforms, trade and tariff reforms, deregulation of prices, financial sector reform, fiscal transparency, improving governance, and a credible poverty alleviation programme.

Our two-pronged strategy has paid dividends. While stabilisation policy succeeded to a large extent in restoring macroeconomic stability and avoiding default, the structural reform measures have laid the foundation for sustained growth. Stabilisation policy succeeded in achieving fiscal discipline and viable balance of payments. Fiscal deficit has been reduced from an average of 7.0 percent of GDP to 5.2 percent in the second year of our government. Current account deficit which averaged almost 5 percent of GDP during the first 9 years of the 1990s reduced to an average of 2.0 percent during the last two years. Consequently, our external debt which was growing at an average rate of more than 6.0 percent per annum during 1990–99 (i.e. rose from \$ 22 billion in 1990 to almost \$ 38 billion in 1999) remained flat over the last two years. Inflation averaged more than 10 percent during 1990–99, declined to an average of 4 percent over the last two years.

Far reaching structural reform measures have also paid dividends despite the fact that unprecedented domestic (drought) and external (global slowdown) shocks diluted somewhat their potential pay offs. Tax collection increased at an average rate of more than 13 percent per annum during the last two years as against an average of less than 5.0 percent during the last three years (1996–99) prior to our government. Exports, which stagnated at around \$ 8 billion, for the first time, crossed this mark and reached \$ 9.2 billion in 2000-01 against an average *decline* of 3.5 percent per annum during 1996–99, exports grew at an average rate of 8.8 percent over the last two years.

Our major weaknesses so far have been growth and investment. The crippling drought of dimensions never experienced in the country, damaged, growth prospects last year despite impressive recovery in industrial growth. The massive debt overhang has slowed investment rate in the 1990. With debt burden gradually reduced, both public and private sector investment will pick up. With lifting of economic sanctions and resolution of the IPP issues in general and HUBCO in particular, looming threat of default is gone with foreign exchange reserves touching percent 5.0 billion mark, enhanced market access and reduction in import duty, improved relations with International Financial Institutions, and Pakistan's enhanced status in the global order, the investment climate has improved both for domestic and foreign investors.

Having achieved a major success on stabilisation front and that a wide ranging structural reform measures have laid the foundation for sustained high growth, the challenges for the medium-term have been to rekindle growth through private sector

participation and efficient public sector investment, thereby creating more employment opportunities and reducing poverty; in addition to achieving fiscal consolidation so that the country's debt burden reaches a sustainable level. It is in this background that we have prepared our medium-term framework covering a period from 2001-02 to 2003-04. The key features of the framework include: taking the economy to higher growth path (5.2 percent –5.5 percent) while keeping inflation at about 5 percent, investment rising gradually from the last year's level of about 15 percent to 17.0 percent of GDP by 2003-04; fiscal deficit declining further to 3.2 percent of GDP and current account deficit (including transfers) to 1.3 percent, development spending reaching close to 4.0 percent of GDP by the end of 2003-04, social sector spending will continue to be receiving highest priority and net foreign exchange reserves building at slightly above \$ 4 billion (excluding commercial banks reserves with the SBP by the end of 2003-04.

The current fiscal year (2001-02) is the first year of the medium-term programme. While fixing the targets for the current year, the impact of possible slow down in global economy was taken into account. However, the unprecedented events of September 11 in the United States have unleashed new and unpredictable forces that have substantially raised the risk of global downturn.

The events of September 11, 2001 have affected Pakistan on two counts. Firstly, to the extent it is integrated with the world economy, the sharp downturn is bound to affect Pakistan's economy. The slower pace of economic activity in Pakistan's major trading partner countries (US and EU and Japan in particular) would reduce their demand for Pakistani products. As such, Pakistan's exports would be lower than the targeted level. Secondly, the events have not only disrupted the trading activities but have also increased the cost of international trade. This disruption is likely to cause a decline in exports and imports. Decline in imports is likely to affect tax revenues as roughly 40 percent of these are dependent on imports. Foreign investment, particularly in oil and gas sector and in information technology as well as privatisation programme are likely to be affected.

We hope that these difficulties are temporary in nature and should not affect our medium term goals of reviving economic activity and restoring macroeconomic stability. This crisis has also opened up new opportunities for Pakistan. We have received grants assistance to offset our budgetary loss as well as support to our balance of payments. We have received substantial debt relief as well. Our debt situation will be stabilised as a result of the package we received from the Paris Club. Our burden of annual debt servicing has been reduced which will provide enough resources to be spent on improving social sector, reducing poverty and reviving economic activity. We have also been provided enhanced market access and reduction in duty which will increase our exports on a sustainable basis. The US EXIM Bank as well as OPIC will facilitate the role of the US private sector in Pakistan. There are many countries negotiating with Pakistan for debt-for-education

swap as well as debt-for social sector swap. This will provide us enough resources to improve our education, health, and social sector in a relatively shorter period of time. Our gross foreign exchange reserves are nearing \$ 5 billion and are likely to increase further in the short-to-medium-term. Most importantly, Pakistan will benefit from the reconstruction and rebuilding of Afghanistan.

Ladies and Gentlemen:

These gains can be translated in strengthening our economy, reducing debt burden, reducing poverty, and improving social indicators provided we remain firm to our commitment and continue to perform well. We have enormous responsibilities on our shoulder. We have embarked on a journey of reconstruction and reform that will bring returns if we stay the course. We are committed to the structural reform programme launched some two years ago. There is no looking back, no role back of reform programme and our economic policies.

Ladies and Gentlemen:

Although a wide-ranging structural reform programme was put in place over the last two year we believe that much remains to be done to restore the momentum of growth, investor confidence, and reducing poverty. We will, therefore, continue to implement an ambitious reform agenda over the medium-term. The key areas of our reform agenda include: restructuring of public expenditure towards growth-enhancing and poverty-reducing outlays; improving monitoring and transparency in public finances; tax policy and tax administration reform; public enterprise restructuring and privatisation; and financial sector and foreign exchange market reforms. In all these areas, the central challenge is to address governance problems that remain a major obstacle to higher growth and better social services. Two additional dimensions of governance will be receiving our highest attention. First, we will assess existing regulation and procedures affecting the interaction between the administration and the business community with a view to eliminating red tape and with it, corruption opportunities by pursuing even more deregulation and removing irritants. Second, we are undertaking judicial reform programme aimed at strengthening the rule of the law and enhancing the transparency and accessibility of the legal system by modernising the court system at all levels and strengthening capacity, effectiveness, and accountability of law enforcement agents.

The government's macroeconomic policy mix will be geared to consolidate macroeconomic stabilisation, revival of economic activity, reduce the public debt burden, while directing expenditure efforts at poverty reduction and social development. We are aware that the need to reduce the debt overhang must be sustained by substantial fiscal consolidation and a continuous reduction in the fiscal deficit over the medium term.

The maintenance of a market-based and competitive exchange rate will remain at the core of our exchange rate policy, while the functioning of the foreign exchange market will be strengthened. Monetary policy will be geared towards containing inflation and supporting a steadfast accumulation of reserves to reduce external vulnerability. It is our considered opinion that if we stay the course Pakistan will regain its lost growth momentum and macroeconomic stability on a sustained basis by the end of our medium-term plan.

Ladies and Gentlemen:

Taking the opportunity of this eminent gathering, I would like to digress a little bit and speak on a subject which is very dear to me. You would agree with me, ladies and gentlemen, that institution plays an important role in the country's economic development. A successful economy requires appropriate institutions. Almost all empirical work on the subject has concluded that institutional quality correlates strongly with economic development. Good institutions facilitate development, it is also plausible that high levels of economic growth spur the development of better institutions.

Ladies and Gentlemen:

We have witnessed the deterioration of the quality of our institutions over the years. Economic pressures on the one hand and lack of motivation on the other have forced many of our scholars to work for personal gains at the cost of their professional excellence. High quality scholars are limited in number in a developing country like Pakistan. Such imbalances in approach have eroded professional excellence. Since the quality of the institution is determined by the quality of the scholars, any erosion in professional excellence is bound to have adverse effects on the institutions. In addition, the role of the press is important so as to provide constructive feedback on policies pursued by the government. The quality of analysis is mixed and should move towards more substantive critique and suggestions rather than mere criticism and no real implemental ideas. It is important that members of your Society actively share their views with the public via the press as this would greatly raise the quality of economic analysis presently available to the Pakistan public via our print media.

The theme of this meeting debt, growth and poverty is very relevant and focuses on the priorities set forth by the government two years ago. In line with the seven point agenda of the President, we have moved on the following areas:

- Developed Debt Strategy and successfully reduced debt burden via Paris Club reprofiling.
- Successfully completed our first Standby Agreement with IMF.
- Completed our IPRSP and obtained PRGF facility.

- Instituted substantial structural reform in major areas.
- Reduction in fiscal and BOP deficits.
- Increased Development Expenditure this year.
- Increased social sector and human development expenditure and focused spending on outcomes.
- Reformed working of Banks and Stock Exchanges and NBFIs to improve retail savings and availability of private sector credit.
- Published 3 year macroeconomic framework.
- Published annual, 3 year, 10 year development programmes.
- Revamped Zakat and Ushr system.
- Doubled Khushaal Pakistan programme to create jobs.

And much more.

I look forward to the deliberations of this Conference with considerable interest. No one has an exclusive wisdom and we can all learn from each other. I wish your Conference success and assure you of my full support to promote your discipline to achieve even higher professional standards and excellence.

Thank you very much.