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Inaugural Address

SHAUKAT AZIZ

Ladies and Gentlemen:

It is my pleasure and honour to address the distinguished gathering of economists, social scientists, intellectuals and renowned personalities from within and outside the country on the occasion of the 19th Annual General Meeting of the Society. This has become an important event in Pakistan where economists and social scientists sit together and deliberate on various issues facing developing economies in general and Pakistan's economy in particular. The Pakistan Institute of Development Economics (PIDE) deserves our appreciation for holding such a conference on a regular basis. In fact, I have been using this platform for the last four years to apprise the nation about the progress we have been making on the economic front and about the policies we have been pursuing. I intend to do the same today.

Ladies and Gentlemen:

Unlike last year, this year's conference is taking place at an opportune time. After witnessing weak and fragile growth for almost three years the world economy is showing signs of rebound. The major growth engines of the world economy are exhibiting stronger growth. This is good news for developing countries like Pakistan. A stronger growth in industrialised countries increases demand for our goods abroad and increases our export earnings. In our region, there are signs that peace and stability will become a reality. The recently concluded SAARC Summit in Islamabad offers grounds for optimism. Peace and stability in the region will immensely benefit the economies of the South Asian region.

The theme of this year's conference is "Institutional Change, Growth, and Poverty". The three elements of the theme are inter-related with each other. Let me share my views on the theme. Good governance plays an important role in enhancing the productivity levels, income distribution and delivery of social services in any country. Needless to add that good governance depends on well-functioning public institutions, which help in prioritisation, formulation and implementation of policies for the welfare of the people. The quality of these institutions deteriorated over the years and we are in the process of rebuilding them, but our task is far from over.

Shaukat Aziz is Federal Minister of Finance and Revenue, Islamabad. He became Prime Minister of Pakistan later in 2004.

Pakistan at present has strong macroeconomic indicators and is poised for an upsurge for economic revival. With the reduction in debt servicing, the country is in a position to increase public expenditures. However, the government wants to ensure that this money does not go waste and is used in a productive way. In view of the fact that well-functioning institutions would help a great deal in effective utilisation of resources, government has initiated major reforms in the various institutions and the Poverty Reduction Strategy Paper (PRSP) highlights these initiatives.

Let me turn to growth and poverty which are the second and third element of the theme. No one would deny that economic growth is the single most important factor influencing poverty. Higher economic growth creates more employment opportunities, increases the level of per capita income and hence, reduces poverty. It is well-known that capital accumulation by the private sector drives growth. Therefore, a key objective of the country's poverty reduction strategy should be to establish conditions that facilitate private sector investment. It is also well known that macroeconomic stability is the cornerstone of any successful effort to increase private sector investment and hence, economic growth.

While growth is absolutely necessary for reducing poverty it is not just the speed of growth which is important; it is the quality or type of growth which is more relevant. In other words, it is not growth, *per se*, which is important; what is important is that the growth should be *pro-poor*—growth in sectors where poor benefit the most.

Ladies and Gentlemen:

I believe that poverty situation in Pakistan is the outcome of sustaining severe macroeconomic imbalances for sufficiently longer period of time. Pakistan has witnessed serious macroeconomic imbalances in the 1990s, owing mainly to the persistence of large fiscal and current account deficits. These imbalances worsened the macroeconomic environment which has had far reaching impact on the country's economic well-being.

By the end of the 1990s, the country was facing three major challenges, that is, rising debt burden, declining investment, and decelerating growth. These three challenges were inter-connected with each other. The rising debt burden was consuming almost two-third of total government revenues on account of annual debt servicing, forcing government to curtail public sector investment. Being complementary in nature, private sector investment also registered a gradual decline. Hence, the decline in overall rate of investment caused economic growth to decelerate. The slower economic growth weakened the employment generation capacity of the economy and caused poverty to rise over the decade of the 1990s.

You would agree that a noticeable decline in poverty requires sustained macroeconomic stability, financial discipline, and consistent and transparent policies. These, along with improved governance and better quality infrastructure would

encourage private sector to play a leading role in promoting investment and growth. The Government on its part will not only identify sectors which are considered to be the major drivers of growth but will also be spending more on physical infrastructure, water, energy, education and health.

Ladies and Gentlemen:

To address the three challenges as I just described, on a path of a concerted effort was made over the last four years. Reduction in “*twin deficits*” (*fiscal and current accounts*) was considered vital for improving the country’s macroeconomic environment, bringing balance of payments to a viable position, and building foreign exchange reserves to strengthen the shock absorbing capacity of the economy. At the same time, wide-ranging structural reforms were introduced to improve the supply side response by removing impediments to private sector development, removing irritants to improve investment climate, and improving the allocation of resources.

Where are we now? Despite series of domestic and external shocks, Pakistan has made considerable progress in overcoming challenges as I just described. Pakistan’s economy is now more healthy; economic policies are consistent, transparent, and predictable; confidence of the private sector is restored which is reflected by the sharp pick up in bank credit to private sector and 14 percent growth in industrial production; expatriate Pakistanis are bringing their capital back, stock market is buoyant, external balance of payments has never been so comfortable; current account is in surplus; foreign exchange reserves have cross \$ 12 billion, sufficient to finance 12 months of imports and stands at 17.4 percent of GDP; exchange rate is stable; inflation is low at around 3 percent; economic growth has accelerated to over 5 percent; interest rate environment has never been so conducive; fiscal deficit has been lowered substantially (*from 7 percent to 4.5 percent and targeted to decline further to 4.0 percent of GDP*); public debt has declined from 110 percent of GDP to 90 percent in the last two years; Pakistan will be pre-paying high cost external debt worth \$ 1.0 billion shortly; both exports and imports are growing by double-digit level; and Pakistan’s credit rating has been upgraded by international rating agencies.

In short, macroeconomic stability has been restored as a result of significant improvement in debt situation and economic growth has accelerated to over 5.0 percent. The country is already witnessing signs of increased level of investment activity in the current fiscal year. Bank credit to private sector during the first half of the current fiscal year stood at Rs 157 billion as against Rs 65 billion in the corresponding period of last years.

Notwithstanding major progress made in many areas and key economic fundamentals improving in a difficult external environment, there is no room for complacency. There are many challenges still lying ahead. The major challenges include:

- (i) taking the economy at higher growth on a sustained basis without compromising on macroeconomic stability;
- (ii) creating employment opportunities;
- (iii) reducing poverty; and
- (iv) reducing social gap.

The government's macroeconomic and social policies as enshrined in the PRSP, will be directed towards meeting these challenges. The stage is now set for growth to accelerate from over 5 percent of last year's level to over 6 percent in the next three years—this is the pace needed for poverty to decline substantially. To achieve growth targets the private sector will have to play a leading role. The government on its part will be working to further improve investment climate and competitiveness of the industries. In addition to its role as a facilitator, the government would increase its poverty and social sector-related spending besides substantially increasing development spending with emphasis on physical infrastructure, water, energy, education and health. We are spending Rs 185 billion on poverty and social sector related programmes this year which has grown by more than 62 percent over the last three years. The Government has also launched various directed programmes such as micro credit, food support programme, Khushal Pakistan Programme, PPAF and others to support the deserving segments of the society.

Ladies and Gentlemen:

As I have stated earlier, it is not growth *per se*, but pro-poor growth is essential for poverty reduction. Accordingly, we have identified five major drivers of growth which have the potential to generate not only *pro-poor growth* but also employment opportunities. These include; (i) agriculture, (ii) housing and construction, (iii) SMEs, (iv) oil and gas, and (v) information technology. The detailed discussion on the rationale for selecting these sectors to accelerate growth, create job opportunities and reduce poverty is well-documented in the PRSP.

While agriculture, housing and construction, and SMEs may generate pro-poor growth, we cannot ignore the other sectors of the economy. A more diversified economy with a vibrant manufacturing and services sectors might offer the best chances for a sustainable improvement in employment and poverty reduction in Pakistan.

Ladies and Gentlemen:

Substantially large portion of our economic activity is in the hands of private sector. They employ 90 percent of Pakistan's labour force. Private sector is, therefore, not only the main engine of growth but it is the main source of employment generation. With accelerated pace of Privatisation the role of the private

sector is further expanding. With Privatisation of Habib Bank, 80 percent banking and financial businesses are now in the hands of the private sector. Although investor confidence has improved considerably over the last four years much more work is still required to further improve investment climate in the country. There are three broad and inter-related elements that shape good investment climate: the macroeconomic environment, governance and infrastructure. While Pakistan's macroeconomic environment has been strengthened and at the same time we have made considerable progress on improving governance and allocating substantial amount of budgetary resources to strengthen the country's infrastructure, much more effort is still required to further improve the two important elements of a strong investment climate.

FUTURE AGENDA OF REFORM

Let me take this opportunity to put before this august gathering our future agenda of reform. Structural change is the essence of development. Reform is a dynamic concept. The country must continue to adjust itself with changing domestic and external environment. Over the last four years we have introduced wide-ranging reforms in various sectors of the economy. These reforms have started yielding results in terms of improved macroeconomic environment. Over the next five years our reform agenda will concentrate on strengthen institutions; improve the competitiveness of our industries; build a robust financial system in an environment of global financial restructuring; further strengthen the tax administration; promote transparency in economic policy-making; and strengthened and expand the role of the National Saving Directorate. While it is not possible to discuss each element of reform as some of them are already outlined in the PRSP. I would nevertheless attempt to provide you the flavour of these reforms.

(i) Institutional Strengthening

As part of institutional strengthening the government will introduce reforms in judiciary, police, civil service, pay and pension, and procurement. Public accountability is essential for maintaining public confidence in government. We are convinced that it is possible to make systematic improvement by pursuing a practical strategy to fight corruption in the country. Details of all these measures are contained in the PRSP.

Tax administration reform is a cornerstone of the institutional reform agenda. A major overhaul of the CBR is being implemented. It aims at increasing the CBR's effectiveness, reduce corruption opportunities, and raise the buoyancy of the tax system through organisational restructuring, self-assessment, elimination of personal contacts between tax-payers and tax authorities, simplified processes, revised terms and conditions for employment of CBR officials, and improved IT

management. We have made considerable progress in these areas but much more will be required to make CBR an efficient tax administration. There are many on-going programmes related to the strengthening of Tax administration which are well-documented in the PRSP.

(ii) Improving Industrial Competitiveness

Improving competitiveness of Pakistan's industries is an important challenge which will receive greater attention of the Government over the medium-term. Although we have made considerable progress in this area, yet we believe that much more needs to be done. In fact we are the various line department officials visiting factory premises once a year and in one day? Is the clearance time from custom has been reduced to within 48 hours? Is the waiting period to get power, telephone and gas connection has been reduced effectively? Is the SME sector getting adequate credit at the current market rate? Is the Universal Self Assessment System has almost eliminated the contacts of taxpayers and tax authorities? Is private sector receiving quick refund of sales tax because of the STARR project? Have gas supply, working of ports, roads, rail linkages, telecommunication network, and water availability improved on the ground?

(iii) Financial Sector Reform

The banking and financial sector of Pakistan is much stronger today than it was ten years ago or in comparison to other countries in the Asian region. However, we have to further strengthen our banking system to meet challenges arising from global financial restructuring. Our future reforms include: privatisation of public sector banks as well as divesting shares through stock exchanges to retail investors; unification of foreign exchange markets by liberalising the inter-bank market and regulating the money changers by transforming them into exchange companies; continue to deal with non-performing loans; restructuring of non-bank financial institutions; to reduce the multiplicity of such institutions; small private banks to undertake voluntary mergers and consolidations to become effective banks; further strengthening of the legal infrastructure of the banking system; a deposit insurance scheme be placed in order to protect the small depositors; central bank actively promoting policies and strategies to export financial services; further liberalisation of financial services in the context of TRIMs; promoting transparency and accountability, observance of international standards.

(iv) Transparency

Transparency in policy is essential for the development of private sector. We are working on further improving our fiscal operation and statistical system Pakistan is already participating in the General Data Dissemination System (GDDS) and our

statistical metadata are posted on the IMF's Data Dissemination Board. We are working towards participating in the Standard Data Dissemination System (SDDS). Details of the reforms are outlined in the PRSP.

(v) Strengthening of CDNS

The Central Directorate of National Savings (CDNS) is an important institution of the country. We are working to strengthen this institution by making it an autonomous entity and expanding its product line to include sale of Mutual Funds so as to offer diversified investment alternatives to investors.

Ladies and Gentlemen:

In the end, let me say that things are moving in right direction which has been acknowledged within and outside the country. We need consistency and continuity of policies and not expect that magic wands will change situation overnight. It requires time for policies to take their course and our experience of the last four years show that if we stay the course, rather than take frequent U-Turn, results can be and will be achieved. A lot is being done and more is needed. There is no room for complacency. Our vision of a strong, vibrant, and stable Pakistan is realistic and based on a lot of thoughts and inputs from various stakeholders including august group like yourselves. Let us work together to bequeath a stronger Pakistan to our future generations. Thank you.