

## *The Presidential Address*

### **Fiscal Decentralisation: Empowering the Provinces, Strengthening the Federation**

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Excellencies, Ladies and Gentlemen,

It is my pleasure to welcome you all to the 26th Annual General Meeting and Conference of the PSDE. I would like to thank you Deputy Chairman and Past President of the PSDE for your time to inaugurate the meeting. I would like to thank our members and many guests who have come from all over Pakistan and abroad to participate in the Conference. A special welcome to students of economics and business studies from PIDE and different universities in Islamabad and from different parts of Pakistan, who are I am sure, just as eager as the senior members to understand the issues to be discussed at the Conference better.

Let me join Dr Musleh ud Din in welcoming our distinguished speakers, Dr Vito Tanzi, Dr Ehtisham Ahmed and Dr Anwar Shah who will be delivering the invited lectures this year. Our chief guest, I might add at short notice, will deliver the prestigious Quaid-i-Azam Lecture this year.

Distinguished Members, I am happy to announce that next year PIDE and the PSDE will celebrate the Golden Jubilee of *The Pakistan Development Review*, more popularly known as the *PDR*. Its first issue came out in 1961. We will also be honouring at this Conference Dr Azizur Rahman Khan, the well known development economist who spent many years at PIDE and who was the first Pakistani Editor of the *PDR* (and contributed the well-known article on Financing Pakistan's Second Five Year Plan in the very first issue of the *PDR*.)

Fellow economists and social scientists, Pakistan today and its economy faces serious challenges and grave threats. From its well-known "Pakistani growth rate of 6 percent" and historical average over the last 40 years of between 5–5.5 percent the economy has been growing in the last three years (2007-08 to 2009-10) at an average of around 2–2.5 percent. Mainly as a result of the unprecedented floods this summer the

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economy is expected to grow at around half the projected growth of 4.5 percent in 2010-11. With inflation at around 15 percent the economy is in deep stagflation.

This is an untenable situation. Despite some silver linings in these difficult times, such as rising global food prices and unprecedented hike in prices of cotton yarn, resulting in a spurt in exports, and growing remittances in the first half of 2010-11, the overall situation, remains grim. Severe energy shortages and security concerns are acting as a major dampener to business confidence and thus to badly needed domestic and foreign investment.

*The fundamental economic challenge Pakistan faces today is how to break-out of stabilisation into higher, sustainable and inclusive growth.* Yes, macro stability is a pre-requisite for sustained growth and for building investors and donors confidence and must remain an avowed aim. But growth is also essential for macro-stability.

The reasons why the current situation of low economic growth is untenable are fairly well established. Our high growth of labour force, at around 3 percent, needs a minimum growth of 7 percent to absorb just the increase in labour force (we must grow faster if current unemployment and underemployment is to be reduced). Lower than this minimum growth means not only a deteriorating labour market situation and rising unemployment and underemployment but also worsening poverty given the close nexus between job creation and poverty reduction.

The much faster growth of countries in the region (China, India and now Bangladesh) at between 7.5 to 10 percent not only makes our growth performance look dour but also means that we are losing competitiveness as faster growing economies experience rising productivity and rising new investment—key driver of new technology, new products and improved infrastructure.

Yet, to my mind perhaps the most important reason to break-out into higher growth is the pall of gloom that is enveloping people in all walks of life—not just in Pakistan, but also Pakistanis abroad as well as well wishers of Pakistan—and this makes fertile breeding and recruiting ground for those who want to destabilise and disrupt the country.

Dr Nadeem ul Haque's theme for the Quaid-i-Azam Lecture in this Conference is "Can Pakistan Grow Faster?", and this with some other papers, will I am sure provide food for thought, spur debate and discussion on this fundamental issue. Let me just say here that the two critical areas where we really need to move forward are revenue generation and economic reforms (especially SOEs) and this requires strong political will which appears to be sadly lacking.

In these difficult and indeed distressing times, without detracting from current economic realities, we can be forgiven for over looking some of the important positive developments that have taken place in recent years, which to my mind can serve as major drivers of growth over the medium and long term. We must start thinking beyond stabilisation.

These are the dividends that flow from having a free and vibrant media, an independent and highly respected higher judiciary and empowered provinces as a result of the 18th Constitutional Amendment. The 18th Amendment is democracy's gift to the people of Pakistan and a vigilant and free print and electronic media together with an independent and strong judiciary the best guarantee for ensuring transparency and good governance. These are essential ingredients for building-up a vibrant economy.

There is perhaps more than a grain of truth in the assertion that we may have not fully done our homework in working out the far reaching impact and implications on the economy of Pakistan of the 18th Constitutional Amendment and 7th NFC award.

I remain convinced, however, that the 18th Constitutional Amendments (together with the 7th NFC) by empowering the provinces will truly strengthen our Federation. Such a Federation was always envisaged by the founder of our Nation, is enshrined in the 1973 Constitution, and had it not been for the constitutional deviations made under military dictatorships, should have been in place much earlier. Any further delay especially in the current geo-political situation may well have been too late.

The fact of the matter to paraphrase in simple words Ahmed and Brosio (2008) important message in the “Handbook of Fiscal Federalism”, is that this is a “learning by doing” process. To quote, “Assignment of responsibilities derives not from principles but from bargaining and competition between government (at different levels)”.<sup>1</sup>

As we have seen in the debate on the collection of sales tax on services or in the delay in the imposition of the R-GST, the change over to the new economic arrangements is going to be challenging and contentious. What is vital is that we learn from the process, feed this back into the decision making mechanism and move towards finding and implementing pragmatic solutions. If we allow the process to get bogged down not only will the economic costs be high but the very fundamentals of the changes may increasingly be questioned.

The theme of this Conference is, therefore, not only timely but addresses some of the very critical issues that arise out of the new economic arrangements stemming from the 18th Constitutional Amendment and 7th NFC Award.

I am very grateful to the contributors to the technical sessions, the panel discussants and those giving the invited lectures for the work and effort that has gone into analysing and addressing critical concerns and issues emerging from the 18<sup>th</sup> Constitutional Amendment and 7th NFC Award—whether they relate to revenue generation, macroeconomic management, infrastructure development, delivery of social services sharing and development of mineral resources and other important issues. This is a new area for many of us, and as important as the papers to be presented, will be the identification of areas for further research and analysis which will emerge from these discussions.

Let me pose a few key questions which I hope will be examined in this context at this Conference.

- How critical is increasing our revenues (e.g. increasing Tax/GDP ratio from 9 percent to 15 percent in the next 5 years) to ensuring the smooth functioning of the new economic arrangements resulting from the 7th NFC and 18th Amendment?
- What changes in the current arrangements are needed to ensure prudent macro-management of the economy to move towards attaining macro-economic stability and reigniting economic growth? Or more specifically how do you ensure effective participation of the Provinces in macroeconomic management and a buy-in from them in meeting macro-economic goals?

<sup>1</sup>Ehtisham Ahmad and Giorgio Brosio (ed.) *Handbook of Fiscal Federalism*. Edward Elgar, UK. p.11 (brackets added).

- With the delivery of key social services (education, health, special welfare) being devolved to the Provinces what role if any should the Federation play in these sectors including ensuring that adequate resources are made available to them and their cost-effective delivery?
- With infrastructure development becoming an important part of the Provincial Development Plans, given the increase in resources now available to the provinces, what should be the demarcation between the Federal PSDP and Provincial Annual Plans in the formulation and implementation of new infrastructure projects? What should be the criteria (e.g. specific sectors, total size of project, coverage, strategic importance) for this demarcation?
- How do you ensure achievement of national and international goals (MDGs) such as poverty reduction and reducing inter-provincial disparities in income and in HDI indicators under the new arrangements?
- What would be the role of local governments in the new arrangements?
- How to ensure capacity in the Provincial Finance Departments and Planning Boards to undertake their new responsibilities? Also how best to fulfill the need for provincial national income accounts and information on key economic indicators at the provincial level?
- What lessons can we learn from international experience including from our neighbour India?

These are but some of the key issues to my mind that need urgent attention.

This Conference would not have been possible in these financially stringent times but for the support we have received from many quarters. I would like to especially place on record our thanks to the Forum of the Federations and its President and CEO Mr George Anderson for their very generous support for the holding of the Conference. Let me also thank for the financial support received, from the Higher Education Commission (HEC), the Canadian International Development Agency (CIDA), our old friends the Friedrich Ebert Stiftung (FES) and USAID.

Last but not least let me thank the Executive Committee of the Society, the Secretary Dr Musleh ud Din and the two Joint Secretaries Dr Idrees Khawaja and Dr Moshin and all the PIDE staff for their untiring efforts in hosting this Conference.

I thank you for your patient hearing.