

Inaugural Address

MAKHDOOM SHAHAB-UD-DIN

It is with great pleasure that I inaugurate the Eleventh Annual General Meeting of the Pakistan Society of Development Economists.

I have noted with satisfaction the contribution this Society has made over the years to add to our knowledge about the importance of development economics, and particularly in comprehending adequately the multi-dimensional character of the development process and for framing fruitful policies to accelerate the rate of economic development. Above all, it has given an institutional shape to the meaningful dialogue between professional economists and policy-makers. I am delighted to see such a large number of distinguished economists from all over the world participating in the Society's deliberations. Only the best results can be expected to come out of such objective discussions about some of the highly topical economic issues of our time. I wish to extend my appreciation to the Society for providing such an effective platform to economists, demographers, and anthropologists.

Today, we stand witness to an unprecedented change in the world economic order. The world economy has finally emerged out of the shadows of a deep-seated recession; and the world GDP is expected to grow at the rate of 3.3 percent in 1995 as opposed to 2.2 percent in 1994; and the expected growth of world trade in 1995 at more than 7 percent per annum, as it was in 1994, offers a sharp contrast to the 1980s. Inflation has been brought down even though the rate of unemployment remains unacceptably high. And the news is not good for the "47 least-developed countries", mostly in Africa, whose growth performance continues to be below average; a very large number of people eke out a precarious existence below the poverty line. Thus, the gap between the rich nations and the poor nations continues to widen. The North-South inequities are very much there even as the world economy exhibits signs of strong growth. The remedy is no longer a simple dialogue between an affluent North and a poor South with a one-point agenda about increasing the size of the flow of aid from the former to the latter. Instead, the nature of the North-South relationship has become more complex, mainly because Japan and East Asia are now competing with the North as net exporters of capital, which to some extent bespeaks a profound transformation in the world trading system. To comprehend this new pattern of relationships in the international economic scene, and to give it a new sense of purpose and direction, regional trading blocks like the EEC, NAFTA, and APEC have been formed. Notwithstanding some advantages of

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such balkanisation of the world economic system into trading blocks, this kind of response to the new challenges is essentially protectionist, and represents a second-best remedy. Another, more hopeful, development is the creation of the World Trade Organisation (WTO) as part of the GATT-brokered Uruguay Round Agreement, which has now been ratified by most developed and developing countries. Whatever else may be said about the Agreement, one thing is absolutely clear: the Agreement consciously seeks to promote a rule-based, multilateral, and non-discriminatory world trading system through the WTO, which will function on the basis of a qualified unweighted majority voting, and in which the membership of the OECD countries will be only 1/3rd of the total membership. Also, long-neglected issues have been addressed: like the OECD agricultural protectionism, the newer threat of aggressive unilateralism of the United States, and the rapid increase in the incidence of non-tariff barriers in the OECD countries, especially against textiles and clothing mostly exported by the developing countries.

Thus, new opportunities are opening up for international economic collaboration, on the basis of equality rather than a special and differential treatment to the less developed countries. International competition for the developed and developing countries will be more fierce as hiding behind the walls of the tariff and non-tariff barriers becomes more difficult under the WTO rules. New restrictions like environmental standards may be imposed on the exports of the developing countries; and intellectual property rights may be guarded much too jealously by the developed countries. All this poses difficulties for the developing countries, which will have to learn rather quickly to adjust to the harsh realities of the post-Uruguay Round era by growing faster, by emphasising the quality of output and not just its quantity, by being innovative and resourceful, and by taking fuller advantage of the rising volume of international trade and investment. On points of dispute with the developed countries, the developing countries must be ready to fight legal battles within the framework of the WTO—which is certainly good news for the lawyers of the world!

I would now like to talk about how Pakistan has fared in the recent past. Pakistan's economy revived somewhat in 1993-94; and some economic indicators registered a modest improvement despite the many domestic supply-side shocks. Notwithstanding the repeated failure of the cotton crop because of the virus and pest attacks, the GDP growth, which had decelerated to a record low of 2.3 percent in 1992-93, has still managed to recover to about 4.0 percent; agriculture has registered a growth rate of 2.6 percent as compared to a negative growth of 5.3 percent last year; the growth of the manufacturing sector was only marginally above the growth rate achieved last year. Above all, there is a greater accent now on financial discipline and on efficient management of the economy. The federal and the four provincial governments have, by and large, adhered to the expenditure restraints

prescribed, even though at the expense of the much-needed public sector development activities. The demand management policies of the Government have worked: the budget deficit has fallen from 7.9 percent to 5.8 percent of the GDP, and the current account deficit has been reduced from 7.1 percent to 5 percent of the GDP in 1993-94. Also, while exports have not increased much, imports have increased at an even slower rate, which has reduced the trade deficit. This, coupled with a greater inflow of foreign investment, has enhanced the foreign exchange reserves from US\$ 347 million at the end of 1992-93 to US\$ 2,285 million at the end of 1993-94. These developments have moderated the rate of depreciation of the par value of Pakistani currency *vis-à-vis* the US dollar and other world currencies. But, all this has not been enough to moderate the rate of inflation, which was 11.2 percent in 1993-94, significantly higher than the inflation rate of 9.3 percent in 1992-93. This is mainly because the commodity-producing sectors have not yet recovered to the extent desired.

Unfortunately, the winter of our economic discontent is not expected to be over soon even as we battle against macro-economic instability. The cotton output is expected to be 7.5 million bales as against the target of 9.5 million for the year 1994-95. This will affect the performance of agriculture and manufacturing significantly; so the GDP growth rate will be restricted to well below the historical trend rate of 6.0 percent or so. Also, the measures taken to "open up" the industrial sector of the economy, though essential to remove the many distortions in the goods market, have increased a few key relative prices, something that will continue to happen in the future as well. Yet another difficulty flows from the reforms which seek to improve the effectiveness of the money market by making a shift from direct regulation to indirect controls and a greater reliance on the market forces. The main financial liberalisation policies are aimed at liberalising the interest rates, reducing the controls on credit, enhancing the competition and efficiency in the financial system, and strengthening the supervisory framework. This contrasts sharply with the earlier regime of direct controls on interest rates movements, domestic credit controls, high reserve requirements, segmented financial markets, absence of well-developed money and securities markets, and commercial banks serving as captive institutions. But the new regime also means that the government has voluntarily traded the greater predictability of direct monetary management for the uncertainties of the market. All this inevitably makes anti-inflationary policies somewhat ineffective at least in the short run. But it is hoped that as the process of structural adjustment is completed, as the commodity-producing sectors respond more positively to greater domestic and foreign investment, and as the money market starts behaving more rationally, inflation may yet be brought down to about 7 percent or so during the next year.

Ladies and Gentlemen: Having outlined the broad features of the emerging macro-economic scenario, I now list a few basic challenges of economic management.

- At the centre of economic reforms lies the task of maximising the long-run growth possibilities of the economy. The rate of economic recovery must be fast enough to attain and surpass the trend growth rate of the GDP of 6 percent plus. Without this happening, the goal of macro-economic stability will remain elusive; and problems like unemployment and poverty will continue to remain intractable. To this end, the rate of investment must be increased substantially. Some of this additional investment is likely to flow from the domestic private sector, but a lot of it must come from foreign sources, for which we will have to compete in the world market.
- In the area of macro-economic management, we need to mobilise adequate tax resources and control public expenditure. The fiscal problem has remained difficult so far because of a narrow tax base, which in turn complicates the task of rationalising the tax rate structure and simplifying the tax administration. A failure to raise enough tax revenue also makes the recourse to domestic and external borrowing inevitable, so that the legitimate non-development requirements can be met and enough allocations can be made for development expenditure. Due mainly to these endemic fiscal disabilities, the goal of balancing the budget has remained as distant as ever. While the budgetary deficit was expected to drop from 5.8 percent of the GDP in 1993-94 to about 4.0 percent in 1994-95, there are indications that this target may not be achieved (mainly because of the shortfall in revenue collection).
Another difficulty flowing from the same source is that tariff rates cannot be brought down quickly enough—even though substantial progress has been made in this direction. While a shift from trade taxes to domestic value-added taxes lies at the heart of a successful reform, the potential tax revenue shortfall from a reduction in the tariff rates impedes this process.
- To translate a higher growth rate of the GDP into a greater per capita availability of goods and services, the rate of population growth must be brought down by a more effective family planning programme, by reducing the under-5 mortality rate, which still remains high in Pakistan, and by raising the present woefully low levels of female education. Success on these fronts will not only maximise per capita income but will also make the life of the ordinary people more cheerful.
- Yet another problem area relates to the inadequate progress made to improve significantly the so-called “human development” indicators—e.g., raising the literacy rate and increasing the longevity of life and access of the ordinary people to such basic facilities as potable water and sanitation—which are the requirements to put *man* at the centre of economic development.

Ladies and Gentlemen: I now outline the basic features of an adequate response to the new challenges that our economy faces.

- In order to accelerate the rate of economic growth well above the historical rate of 6 percent plus, it is absolutely essential that a dynamic balance is achieved between the growth rates of the agricultural sector and the manufacturing sector in such a manner that while the growth rate of agriculture is raised to about 5 percent or so, the manufacturing sector must rise at the higher rate of 8–10 percent on a sustainable basis. This needs to be done in order to deepen the process of structural transformation, and to make it irreversible. Yet another essential element of this high growth rate strategy is to increase the rate of investment to about 25 percent; and to increase the efficiency of investment by raising the total factor productivity.
- On the supply side, a strong programme incorporating a widespread availability of family planning services is required to accelerate the rate of fertility decline. For the majority of the rural population, the lack of access to such services is hindering the success of the family planning programmes. The data from all the fertility surveys clearly indicate a strong unmet demand for contraception in both urban and rural Pakistan.
- Successful economic management also requires taking steps to reduce the incidence of unemployment, especially open unemployment. According to some estimates, the open unemployment rate is already nearing the 6 percent mark. A substantial part of the solution lies in accelerating the growth rate of the economy, especially of the agricultural sector, where about 50 percent of the total labour force is engaged; but a series of ancillary employment-generating programmes will have to be launched too. Above all, substantial investment will have to be made in efficient labour-intensive production techniques, which, in turn, would necessitate making adequate allocations to R&D expenditures both by the public and the private sectors.
- Yet another element of an effective policy response is to make the process of fiscal reforms irreversible—by efficient and equitable resource mobilisation, by rationalising the size and composition of public expenditure, and by keeping an optimal balance between the development and non-development expenditures. Also, the large size of domestic and external debt must be managed carefully, and the tax administration should be made simple and efficient. As I have noted, some modest progress has already been made along these lines. However, a lot remains to be done. And for this a bipartisan national commitment is required.

- Finally, I must emphasise the need to take decisive steps to enhance the level of human empowerment in our society, to improve the quality of governance, to reduce the gender gap, and to put an end to such inhuman practices as child labour and bonded labour, which darken the face of Pakistani society.

Ladies and Gentlemen: What I have said so far adds up to a very tall order, and requires a balanced and determined approach to the task of economic development, as well as a firm commitment to raising the standard of living of the people.

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