The Pakistan Development Review
41: 4 Part I (Winter 2002) pp. 313–317

Inaugural Address

SHAUKAT AZIZ

Ladies and Gentlemen:

The 18^{th} Annual General Meeting of the Pakistan Society of Development Economists (PSDE) is taking place at an opportune time. The country has witnessed a smooth transition to democracy. There is now an elected government in place, fully charged with enthusiasm to improve the life of the common man by building a strong and vibrant economy. While we are in the process of finalising our economic agenda for the next five years, we would certainly welcome suggestions for improving the country's economy from this august gathering. Knowledge is not the exclusive wisdom of the people at the helm of affairs. Some of the best brains in economics and other social sciences are participating in this conference and will be deliberating on various aspects of Pakistan's economy for the next three days. I shall be looking forward to receiving their recommendations.

The last Annual General Meeting of the Society had taken place at the backdrop of the events of 9/11 which, as we all know, have changed the complexion of the global economy. The performance of global economy has remained disappointing, by and large, since the events of 9/11. This year's Annual Meeting is taking place in an environment of extreme uncertainty as the threat of war in looming large in Iraq. There is a general perception that an armed conflict in Iraq could thoroughly shake the already fragile world economy, causing disruption in oil supplies to the rest of the world, particularly Asia, which has little oil reserves of its own and remains heavily dependent on imports. Such disruption is bound to cause an oil price hike, rising economic uncertainty, and a decrease in business and consumer confidence. Recent estimates suggest that a sustained price hike of five dollars per barrel of crude oil would slow down growth in world economy by 0.3 percentage points with Euro zone and the Untied States witnessing a drop in GDP growth by 0.4 percentage point. To the extent Pakistan is integrated with the world economy, the slow-down is likely to cause temporary difficulties for us as well. The avoidance of war in Iraq, therefore, is in the best interest of the global economy in general and the developing countries in particular.

It is my pleasure and honour to address the distinguished gathering of economists, social scientists, intellectuals and renowned personalities from with and outside the country on the occasion of the 19th Annual General Meeting of the Society.

Ladies and Gentlemen:

Exactly one year ago from this platform I had briefed the audience about the state of the economy, the policies we were pursuing, and our medium-term

Shaukat Aziz is Adviser to the Prime Minister on Finance, Planning, and Economic Affairs, Islamabad.

challenges. I am happy to state that during the last one year Pakistan's economy has gained more strength. It is stronger today than it was a year ago.

Despite a series of domestic and external shocks such as an unprecedented drought, the events of September 11, and the military build-up of India, Pakistan's economy has made commendable progress during the last three years. The economy is now more stable; economic policies are transparent and predictable; confidence of the private sector is restored; expatriate Pakistanis is bringing their capital back; stock market is buoyant; external balance of payments is in comfortable position; foreign exchange reserves have crossed $9.4 billion and are sufficient to *finance ten-and-a-half months of imports*; exchange rate is stable; inflation is low and interest rates are declining; domestic and external debt have declined; fiscal deficit has been lowered and current account balance is in surplus; tax collection is growing; exports have picked up; governance has improved; and lastly, Pakistan's credit rating in international capital markets has also improved. These economic achievements owe heavily to sound economic policies, good governance, and deft economic management. This fact is, by and large, accepted by stakeholders within and outside Pakistan.

These improvements must be viewed in the backdrop of major challenges that we had confronted some three years ago. These challenges included (i) stabilising the country's debt situation with a view to restoring macroeconomic stability; (ii) reviving investment and growth; (iii) preventing people from falling below the poverty-line; and (iv) improving governance. These challenges were interconnected with each other. For example, a rising debt burden, which consumed almost two-thirds of total government revenues on account of debt servicing, compelled a curtailment of public sector investment. Being complementary in nature, private sector investment also declined because of the decline in public sector investment. There was also a crowding-out effect. The decline in the overall investment rate caused deceleration in growth which, in turn, reduced the employment generation capacity of the economy. The obvious outcome of declining economic growth has been the rise in poverty. Poor governance also contributed to slowing Pakistan's economic growth and raising the levels of poverty. It is axiomatic that declining investment and growth in the 1990s was the mirror image of the prevalent macroeconomic environment at that time.

Given the nature and depth of the challenges, we had two options. First, to address all the four challenges simultaneously, that is, stabilise the debt situation, promote investment and growth, reduce poverty, and improve governance at the same time. The second option was to prioritise the challenges and address the core issue first. After extensive deliberation we decided to adopt the second option for the following reasons: (a) we did not have the capacity to address all the issues simultaneously; (b) to address all the issues simultaneously we had instruments whose outcomes were conflicting in nature. For example, the root-cause of rising debt burden has been the persistence of large fiscal and current account deficits. Pakistan, on average, sustained fiscal and current deficit of almost 7 percent and 5 percent of GDP, respectively, during the 1990s. Large "twin deficits" caused rapid accumulation of domestic and external debt, which increased the country's vulnerability to shocks, reduced investment, and consequently slowed economic growth and led to the rise in poverty.

In an environment of severe macroeconomic instability, one cannot expect the private sector to come forward and increase investment. Macroeconomic stability is absolutely vital for promoting private sector investment and growth. The other option in such an environment has been to increase public sector investment, *à la* Keynesian approach, to kick-start the economy. With 64 percent total revenue consumed by debt servicing alone, there was no room for massive public sector development programme without further aggravating the country's already unsustainable debt situation and creating even more macroeconomic instability. Thus, the challenges of promoting investment, taking the economy to a higher growth path, and reducing poverty could not have been addressed without restoring macroeconomic stability. In other words, without addressing the debt situation first, the foundation for achieving higher and sustainable growth could not have been laid.

It is in this background that we decided to address the issue of severe macroeconomic instability, and place the economy on a path of high sustained growth, financial stability, and improved external balances, by undertaking a comprehensive set of economic stabilisation and structural reform measures. Reducing "twin deficit", i.e., fiscal and current account deficits, with a view to minimising aggregate imbalances and building up foreign exchange reserves with a view to strengthening the shock-absorbing capacity of the economy and restoring financial sovereignty of the country, was the key objectives of stabilisation policies. It is well-known that stabilisation alone does not guarantee growth. Therefore, stabilisation policies were supplemented by a series of wide-ranging structural reforms, which were needed to enhance economic incentives and improve resource allocation, as well as to remove impediments to private sector development.

Ladies and Gentlemen:

A natural question to ask would be: What are the outcomes of our policies? Have we succeeded in restoring macroeconomic stability? As I have stated at the very outset of my speech, we have achieved a modicum of stability; fiscal deficit, which averaged 7.0 percent of GDP in the 1990s, was reduced to 5.1 percent last year and is projected to decline further to 4.4 percent in the current fiscal year; current account deficit, which averaged almost 5.0 percent of GDP in the 1990s, has turned *surplus* to the extent of 2.1 percent last year and the surplus is likely to be even higher this year. As a result of significant improvement in the "twin deficit" situation, our debt situation has also improved considerably. Domestic debt, which was increasing at an average rate of 16 percent per annum during 1990-99, *declined,* in fact by 2.5 percent last year. It is projected to decline further this year. External debt and foreign exchange liabilities, which stood at around $38 billion or 335 percent of foreign exchange earnings, declined to about $36 billion or 233 percent of foreign exchange earnings last year. These are projected to decline by 200 percent this year. Decline in debt has created fiscal space. Debt servicing as percentage of total revenue was about 64 percent in 1998-99. It declined to 47 percent last year, and is projected to decline further, to 44 percent this year. We succeeded in keeping inflation below 4.0 percent. Interest rates are on the decline. The weighted average lending rate was 15.4 percent in 1998-99 but has now been reduced to 10.6 percent. This is going to decline further. Our foreign exchange reserves are above $9.4 billion, sufficient to finance, as I said earlier, ten-and-a-half months imports. Reserves are likely to cross $10 billion even before the end of the current fiscal year. As a result of strong build-up in reserves, our exchange rate is not only stable but it is predictable as well.

We need patience. Things do not improve overnight. After three years of hard work our economic situation has stabilised. Our economy has now reached the take-off point. We are already witnessing signs of the take-off. The first half (July-December) of the current fiscal year (2002–03) has just ended. The performance of key economic indicators is highly encouraging. Exports are up by 16.6 percent; imports are up by 18.7 percent; and most importantly, non-food non-oil imports are up by 22 percent and machinery imports are up by 34 percent. This is a clear reflection of growing economic activity in the country. This can be further ascertained from the facts that tax collection is up by 15 percent and, importantly, sales tax from domestic economic activity is up by more than 41.4 percent. Inflation continues to remain below 4 percent (to be exact, 3.6 percent!) during the first half of the current fiscal year. Remittances were close to $1.8 billion and foreign investment was $474 million during the first 5 months of the current fiscal year. Our foreign exchange reserves stood at $9.335 billion on December 31, 2002. We have added $31.1 billion to our reserves during the first half of this fiscal year.

Ladies and Gentlemen:

Improvements in Pakistan's economic fundamentals have had their impact on the Karachi Stock Exchange. You would be happy to know that Karachi Stock Exchange has witnessed phenomenal growth in the year 2002 and was regarded as the best performing market in the world. Share index and market capitalisation more than doubled in 2002. The month-wise turnover of shares jumped from 907 million in December 2001 to 6.73 billion in December 2002, thus recording a phenomenal growth of 642 percent. The rising trend in the shares index continued during the month of January and market closed at 2869 on January 11. We hope that by the end of this month the market may breach the index level of 3000.

Ladies and Gentlemen:

As I have mentioned earlier, we need patience. Although our policies have started paying dividends, yet there is no room for complacency. Through three years of hard work we have laid the foundation for a strong economy capable of delivering sustainable high economic growth, low inflation, and a viable balance of payments.

Having achieved a modicum of stability, the next five years would witness government resolve to improve the life of the common man, by creating employment opportunities through pro-poor growth policies and keeping inflation at the current level. Our vision for the next 5 years includes:

- Improving the life of the common man.
- Creating employment opportunities through promoting higher investment and growth.
- Taking real GDP growth to 6 percent from the current year target of 4.5 percent.
- Raising per capita income by 42 percent in 5 years.
- Reducing poverty by 25 percent from the current level of about 30 percent to 22.5 percent.
- To achieve such growth targets, investment must rise to 18 percent from the current level of 15-16 percent of GDP; and saving rate must rise to 16.5 percent from the current level of 15 percent.
- Inflation to remain below 5 percent.
- Fiscal deficit declining to less than 3 percent of GDP from the current year's target of 4.4 percent.
- Public debt declining to 76 percent of GDP in 5 years from the current level of about 97 percent.
- Current account deficit to range between 1.0 to 1.5 percent of GDP during the next 5 years.
- Development spending to rise above 4.0 percent of GDP from the current level of 3.3 percent.
- Social sector development will continue to be the cornerstone of the government's economic policy.

The pre-requisites to achieve these targets include:

- Political stability in the country.
- Regional stability.
- Better law and order situation in the country.
- Continuation of consistent and transparent economic policies.
- Completion of the structural reform programme.
- Most importantly, we must continue to remain fiscally responsible.

Thank you.