

## *The Presidential Address*

### **“Economic Reforms for Productivity, Innovation and Growth”**

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Finance Minister, Dr Abdul Hafeez Sheikh, Dr Nadeem Ul Haque, Patron of the Pakistan Society of Development Economists, and Deputy Chairman Planning Commission, Past Presidents and Distinguished Members of the Society, Excellencies, Ladies and Gentlemen!

It is my pleasure to welcome you all to the 28th Annual General Meeting and Conference of the Pakistan Society of Development Economists.

On behalf of the members of the PSDE, I would like to thank you, Finance Minister for having spared your precious time to open this important meeting. I would also like to especially thank our members and guests who have come from different parts of the country and from different continents to participate in the Conference. We are extremely pleased to see here today many young students—Pakistan’s future economists and business leaders—who I am sure are enthusiastic to learn from the many leading specialists attending this Conference on the critical economic issues and challenges that we face at the global, regional and national levels.

Let me join Dr Musleh ud Din in especially welcoming Professor L. Alan Winters, Professor of Economics, University of Sussex, United Kingdom, who will be delivering The Mahbub Ul Haq Memorial Lecture later today; Professor M. Ali Khan, Abram Hutzler Professor of Political Economy, Johns Hopkins University, USA who will be delivering the Gustav Ranis Lecture; Dr Yannis Papantoniou, Former Economy and Finance Minister of Greece, and currently President of the Centre for Progressive Policy Research, Athens, who will deliver The Allama Iqbal Lecture; and Dr Ishrat Husain, Dean and Director, Institute of Business Administration, Karachi, Former Governor, State Bank of Pakistan who will be delivering the Quaid-i-Azam Lecture this year.

In continuation of the tradition started last year by the Pakistan Society of Development Economists (PSDE), the Society will this year be honouring Professor S. M. Naseem to acknowledge his outstanding contribution to the field of Economics and for his pioneering work on Pakistan.

I am happy to announce that I as the President of the PSDE have received a letter from Prof. Joseph Stiglitz, the noble laureate, and President of the International

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Economic Association (IEA) inviting PSDE to become a member of this prestigious association. I will be putting this up at the Annual General Meeting of the PSDE on Thursday.

*Ladies and Gentlemen*

The Pakistan economy is today faced with two formidable challenges.

The first is to breakout of the current stagflation in which the economy is mired, characterised by low growth—an average of 3.0 percent in the last five years—and double digit inflation, even if the latter, at least temporarily, is showing signs of abating. Most worrying is the decline in investment which almost halved to 12 percent of the GDP in 2011-12, compared to five years earlier.

The second is to move the economy decisively to a higher, sustained and inclusive growth trajectory.

The average growth of 5 percent which we achieved over the last 60 years, though satisfactory by yesteryear standards, is today neither sufficient nor impressive when compared with the experience of the East Asian economies, China and India.

Our continuing high growth rate of population and resulting labour force dictates a 7 to 8 percent economic growth to create productive and remunerative jobs for the growing “youth bulge”, the result of the demographic transition we are currently witnessing. If we do not do so, we will face, as we are indeed already seeing around us, social unrest and disharmony, ignited by frustrated youths whose expectations are not met. The expected gains from the “demographic dividend”, could increasingly turn into a “demographic disaster.”

Third, Pakistan needs today not only higher growth but more inclusive growth to ensure social harmony through development and uplift of less developed provinces and regions especially Balochistan. Only then will we be able to overcome the social disorder, rising conflict and deteriorating law and order situation that is increasingly infecting these areas.

This is indeed a challenging if not a daunting economic agenda. It requires first and foremost the restoration of macro stability. It requires structural change to make the economy more efficient, productive and globally competitive. And it requires strong, democratic and transparent institutions that ensure the rule of law, enforcement of contracts, speedy and timely justice and the establishment of the writ of the state in every part of the country.

These three pillars of development—macro stability, structural change and strong and well-functioning institutions—are the key to Pakistan’s growth and development.

While we must move with determination in all the three areas, we also increasingly realise that structural change especially in the case of Pakistan is an essential condition for both macro-stability and ensuring well-functioning institutions which foster growth and development.

The reverse—and here I speak in the narrower economic sense—is also true. Even if we are to achieve macro-stability there is no guarantee that higher growth will result. Also well-functioning institutions together with requisite social and physical infrastructure may provide the condition but again not necessarily spark higher growth.

As Ocampo (2005) and other development economists have rightly argued that the critical factor to develop the momentum for higher growth is structural change. It is only structural change that can unleash the dynamic forces of innovation and entrepreneurship, leading to sustained productivity gains and higher than-average economic growth.

It is for this reason that the theme for this year's Conference is focused on economic reforms which will bring about the structural change to ensure macro-stability as well as unleash forces that will propel the economy to a higher growth path.

Together with economic reforms the key variable in the theme for this year's conference is "innovation".

Innovation is both the production of new goods as well as the production of existing goods and services differently so as to cut costs and find markets in a fiercely competitive global economy. The result of innovation in the Schumpeterian sense is "creative destruction" as new firms and economic activities replace the old and the inefficient.

The purpose or thrust of economic reforms therefore is to dismantle the barriers that stand in the way of innovation and the entry of new entrepreneurs and firms. These barriers also increase the cost of doing business for existing firms and make them uncompetitive especially in global markets.

Economic reforms aim to do away with "economic rents" or unjustified profits that vested and powerful interests enjoy at the expense of the consumer and in the process open up opportunities which potential entrepreneurs and new firms can exploit.

Unfortunately over the years as the Pakistan economy has grown these vested interests too have grown. More and more groups have become beneficiaries of "economic rents" through the continuation of high and imposition of new barriers on trade and domestic competition, on award of contracts on the basis of contacts and connections or underhand deals, gifts of state lands and plots and undeserved subsidies.

These rents have resulted in not only an inefficient and low growth economy and stifled innovation but also sent out the wrong message of what you need to do to be economically better off and succeed in the country. The industrialised world is only now discovering the so called "1 percent" of the population who have enjoyed super normal profits on the backs of the rest who had to bear the brunt of the financial meltdown. We have so many and for so long that we have stopped counting.

The functioning of such an economic system has led rightly to a sharp reaction, discontentment and frustration especially amongst the young and those in the less developed areas of the country.

But where is the lobby for economic reforms as a former State Bank of Pakistan Governor recently lamented, and why is "Pakistan and the IMF: A Road to Nowhere!" as a senior Pakistani economist in exasperation titled his recent lecture at PIDE.

It is here I believe that the role of the economists and the Pakistan Society of Development Economists (PSDE) becomes vital. It is we who must make a convincing case for economic reforms, it is we who must lobby for reforms, it is we who must show the moral and intellectual courage to stand for reforms against vested interests and it is we who must generate the momentum to convince the political leaders, the higher judiciary, civil society, the print and the electronic media, on the urgent need to undertake

and implement reforms—for these are not just essential to revive growth but essential for our very economic survival.

#### *Ladies and Gentlemen*

This is not to say that efforts have not been made or important reforms have not been undertaken. Many initiatives have taken place including in the last four and a half year and most important of which are the 18th, 19th and 20th Constitutional Amendments which have devolved power to the Provinces. The opening up of trade with India is a bold measure which if successfully tapped can open up a much needed vent for economic growth. There are others on which I am sure the Finance Minister will elaborate.

Also let us not underestimate the challenging and difficult times we live in. Reforms as we have learnt from historical experience are best undertaken and most manageable when the economy is growing and not when it is in a down turn or recession. In this sense the periods of the 1980s and the last Musharraf government were a “lost opportunity”.

Also the continuing war in Afghanistan and its spill-overs into Pakistan have cost the economy dearly—approximately US\$ 6-8 billion annually over the last ten years—in loss of assets and economic growth—the latter almost 1½ percent of GDP. The war on terror to which we are all committed has also cost the country in terms of increase in defense and security expenditures.

Then there has been the global financial meltdown, ensuing global recession and anaemic global economic recovery. These have adversely affected our exports despite a creditable performance in 2010-11. The floods of epoch proportion in 2010 and the floods last year also cost the economy dearly.

That said, I do believe that economic management, even in these trying times could have been better. If the political will and commitment had been there to undertake economic reforms, the results could have been much better.

With hindsight, not in a way of criticism but more to learn from experience, let me point out a few critical areas where things could have been done better or differently.

On the scope of reforms there should have been greater focus and concentration on a few critical areas rather than spreading ourselves too thinly or pontificating a grand vision.

The four critical areas of economic reforms I feel we should have concentrated on are:

- (i) Increasing the tax to GDP ratio by imposing the R-GST which would have increased revenues, better documented the economy, reduced the unsustainable fiscal deficit, and allowed the government to undertake much needed development expenditure especially in education and HRD.
- (ii) Tackle from day one on a top priority basis the energy crisis through a combination of short-term measures (adjusting prices to reduce the circular debt, upgradation of existing plants, importation of LNGs, cutting line losses) and implementing medium term energy projects on a fast track (e.g. small dams). That such efforts can reap results in a short time can be seen today—though it appears only Ms. Nargis Sethi<sup>1</sup> has the will and management skills to do so!

<sup>1</sup>Then Secretary, Ministry of Water and Power, Government of Pakistan.

- (iii) Stop the bleeding of public sector enterprises by putting in place professional non-political management, involving workers and managers in setting realistic performance targets and incentives for achieving them and involving private sector to run selected operations on a commercial footing.
- (iv) Accelerate tariff reforms by both bringing down the effective rates of protection and more importantly the notorious SROs. The latter is a hornets nest but bold action was needed if the economy is to be made globally competitive.
- (v) On the timing and sequence of reforms the two areas where a nuanced approach would have been better are:
- (vi) The 7th NFC award should have been made conditional on the provinces agreeing to the R-GST, to bring services and agriculture into the tax net, and show increases in their own revenues.
- (vii) The increase in agricultural commodity prices especially wheat should have been more gradual given the sharp fluctuations in world prices and the high food inflation it injected into the economy.
- (viii) Let me in the end say that with elections fast approaching it is important that each political party clearly spells out its economic programme and more importantly its economic reform agenda. These should be subject to critical debate such that a minimal reform agenda emerges on which there is a broad consensus.

The economists, I must again reiterate here, must play an active role in the development of this consensus on economic reforms with critical analysis and new ideas and approaches especially on the detailed mechanisms for implementing reforms.

This is the time to stand-up and be counted.

I thank you for your patient hearing.

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