

## **Pakistan Economic Horizons, 2003 And Beyond**

Closing Remarks At The Daily Times seminar held at Karachi on January 31, 2003

I would like to emphasize that we are now entering the next phase of our economic revival strategy aimed at reaching a trajectory of 6 percent growth rate by 2004-05. This country had witnessed growth rates of 6 percent over a long period of time and as a consequence poverty was reduced from 40 percent to 18 percent in 1988-89. Thus it is imperative that we go back to that growth path of 6 percent to be able to make a dent in unemployment and poverty. Why do we feel that we can attain this target rate within the next two years and why has the growth record been so poor during the last three years. Let me address the second question first.

The period 1999-2000 was devoted to get the country out of the debt trap and move towards a path of economic self reliance and economic sovereignty. In 1999, Pakistani economy was already under the shell shock of the May 1998 events, the freezing of foreign currency accounts, nuclear sanctions, suspension of bilateral and multilateral assistance. The take over of the Government by the Military in October 1999 further made the problems worse as additional sanctions were imposed for suspension of democracy. The attitudes of the main donors and multilateral institutions, who used to fill in the gap between our external resource requirements and the availability of external finances from our own resources, became much

hardened and harsher. The country's unencumbered liquid foreign reserves were hardly sufficient to meet the imports of next two to three weeks and we didn't know as to how we will meet our oil payments or debt servicing tranches. This was a totally unsatisfactory situation and we had to find a durable and long lasting solution for our external debt.

The first order of business was therefore to get out of the debt trap. For this to happen, fiscal deficit had to be brought down from the level of 7 percent of GDP to 4 or 3 percent by raising revenues and reducing expenditures. The Government's focus thus was on stabilization. When you have a situation where a patient has heart disease, liver disease and pains, you first have to get things in working order. In 1999-2000, the country's debt servicing obligations amounted to \$ 7.8 billion and there was no way we could repay such huge amount of money out of our foreign exchange earnings. This amounted to 60 to 70 percent of foreign exchange earnings including the SBP purchases from the market.

We made all possible efforts to ensure that no payments to foreign portfolio investors or foreign companies such as Hubco were stopped so that the country's credibility which was very low at the time could be restored. Credibility had to improve as we were engaged in public dispute with IPPs and foreign investors were shying away for this and other reasons. Our worst critics also admit that Pakistan's

standing in international financial markets has improved quite significantly and our sovereign ratings are gradually moving upwards.

To improve debt sustainability the following actual cash payments were made by SBP on account of external debt servicing during the last three years.

	<u>Rs. billion</u>
1999-2000	3.756
2000-2001	5.101
2001-2002	<u>6.327</u>
	<u>15.184</u>

These amounts include retirement of \$ 4.5 billion of commercial and short term debt and other foreign currency liabilities. These payments were possible because of purchases of workers remittances through the kerb market in the first two years and heavy inflow since September 11, 2001. We were able to manage debt servicing in an orderly manner because the following amounts due on debt servicing to Paris Club and other creditors of Rs.9.1 billion were rescheduled.

	<u>Rs. billion</u>
1999-2001	4.081
1999-2002	2.795
1999-2003	<u>2.243</u>
	<u>9.119</u>

This strategy of debt reprofiling of Paris Club debt over a period of next 38 years, early and pre-payments of commercial and short term debt and substitution of soft term loans by international financial institutions for hard term loans has gradually led to lowering of our external debt indicators. We are committed to retiring non-concessional loans of World Bank, Asian Development Bank and IMF before time. The new loans from these institutions are all concessional in nature – zero interest rate, 10 year grace period and 30 years repayment. If the current trends persist we expect that external debt servicing ratio which has already come down to 40 percent will further decline to 25 percent of our foreign exchange earnings. This is a level where we will feel comfortable, as we will be able to meet these obligations from the country's own resources without recourse to exceptional balance of payments financing from international financial institutions.

I must also submit that the period of stabilization has taken longer than we had originally envisaged. But this is how the real world works. Man proposes and God disposes. If the country did not have to face four different shocks the stabilization would have been completed in two years instead of three. The prolonged drought for last three years dwindled irrigation water supplies and affected our main economic sector i.e. agriculture. September 11, 2001 made Pakistan the front line state in the war against terrorism and inflicted a lot of damage to the economy including cancellation of export orders. Border tensions with India and mobilization of troops

raised our defence expenditure which the Government had frozen in nominal terms since 1999-2000. Domestic violence against the foreigners such as bomb blasts in Karachi and Islamabad did deter the foreign businessmen from visiting Pakistan and intensifying economic relations. Had these events not taken place the first phase of stabilization could have been completed at least a year earlier.

We are now entering the second phase of economic revival i.e. stimulating growth and employment in the country. All indicators so far suggest that there is a strong likelihood that GDP growth this year (2002-03) will be 4.5 percent. We believe that if all things remain constant and no unforeseen adverse event takes place the growth rate in 2003-04 will range between 5 and 5.5 percent and hit the target of 6 percent in 2004-05. What are the underlying assumptions, parameters and factors that lie behind these projections?

First, we think that the effects of drought will wither away and irrigation water supplies for both rabi and kharif seasons will resume to their normal levels. Water conservation techniques adopted by the farmers in the hard times will increase overall agricultural productivity and agriculture value added will increase at the historical rate of 4.5 percent. Livestock will continue to expand its share within sectoral value added.

Second, barring a fierce and prolonged war in Iraq, global recession will begin to dissipate and all the three main blocks – US, Euro area and Japan – will show

buoyancy. Increased demand for goods and services from these blocks will induce further exports from Pakistan.

Third, as a result of lower debt servicing costs and higher tax revenue collections the size of public sector development expenditure will rise from Rs.130 billion to Rs.150 billion in 2003-04 and Rs.180 billion in 2004-05. This will help give a spur to private sector investment also. Tax revenues are projected to increase from Rs.460 billion this year to Rs.560 billion in 2004-05. You may recall that tax revenues have already risen by Rs.100 billion or 33 percent in last three years. The projected increase of 21 percent in the next two years is therefore very much in line with the past performance.

Fourth, as all of you know the large investment in balancing, modernization and replacement in textile industry during last few years will start paying dividends in form of better quality and higher value added exports. The share of value added items in total textile exports has already exceeded 60 percent and it is postulated that this share will be almost 70 percent by 2004-05.

Fifth, monetary and credit policies and banking sector reforms implemented so far will show some results in form of expansion in credit to housing, consumer financing, SME, agriculture sectors. As these sectors have strong backward and forward linkages the multiplier effects of aggregate demand expansion will reinforce growth impulses in the economy and induce supply and production response.

Sixth, the devolution of powers to local governments to deliver essential services at the grass root level will improve the effectiveness of development spending. As most projects will be driven by the demands of the community rather than imposed unilaterally by central planners, it is expected that waste and leakages will be kept at a minimum level.

Seventh, one of the major drivers of cost in the economy is electricity tariffs. Both the households as well as industrial units are facing unviable power tariffs. With the commissioning of Ghazi-Brotha project, the thermal-hydel mix will change. As more thermal power is switched to natural gas from furnace oil, losses in transmission and distribution are curtailed and financial charges of IPPs are cut down by prepayment of expensive debt power tariffs should come down and benefit the consumers.

Finally, the standards of governance set by the government in last three years should be sustained and further steps are taken to minimize corruption and leakages in financial transactions. Merit remains the basis for recruitment and promotion in public service and nepotism and favoritism are no longer the norms.

As you can see from the above that in this scenario we haven't still relied on private sector investment as the engine of growth. Public sector investment will go up from 4.7 percent of GDP to 6.2 percent in 2004-05 while private sector investment will remain at 9.4 percent – not much different from the current level of 9.2 percent.

Let me conclude by saying that if the existing policies continue, standards of good governance are not weakened, institutional reforms and restructuring are implemented and the country does not face any setbacks in the future, Pakistan would be able to attain a 6 percent growth path and thus reduce poverty and unemployment. There is no doubt in my mind that this is a realistic goal to achieve – something we have done in the past for four decades. But this requires hard work, dedication and honest dealings by every Pakistani whether in the private or public sector.