

**GOVERNOR'S INTERVIEW IN PTV 'NEWS NIGHT' PROGRAMME  
OF 15<sup>TH</sup> MAY, 2002**

**Talat Hussain:** Assalam-o-Alaykum, You are witnessing the 'News night' with Talat Hussain. We are happy to have with us today in our studios the Governor, State Bank of Pakistan, Dr. Ishrat Husain. Governor Saheb! Thank you very much for coming to this programme. Viewers, we will talk to the Governor on the country's economic situation and on certain debates, which are taking place with regard to investment and foreign exchange reserves. We would ask some questions on these issues and would like the Governor to answer them. Dr. Saheb! Are you satisfied with the performance of the economy as the Governor, State Bank of Pakistan?

**Governor:** First of all, you have to determine what our objectives were and to what extent these objectives have been achieved. The first major objective for the last two and half years was to reduce our debt burden and to improve our position on international repayments. The popular expectation was that the default would take place either today or tomorrow. The second objective was to control the fiscal deficit. This was mounting continuously because the Government's expenditures always remained higher than its revenue receipts. So, we tried to control this fiscal deficit by

curtailing government's expenditures. The third objective was to improve the growth rate which had considerably declined during the last ten years and to create employment opportunities for the welfare of the common people. We have made progress in achieving two of the three objectives and are satisfied with the progress made in this regard. However, we have not yet succeeded in achieving our third objective of increasing the growth rate, improving the living standards of the common people and generating new employment opportunities.

**Talat Hussain:**

Reference your first two objectives, country's foreign exchanges reserves have now gone up to nearly 5.6 billion dollars from nine hundred million or one billion. People say that the figure of foreign exchange reserves has been manipulated for political gains whereas the actual figure is different from that. As Governor State Bank, what do you say?

**Governor:**

First of all, I would submit that the State Bank had introduced transparency to such an extent that we publish all the information/data in our Annual and Quarterly Reports and also put them on our website. We kept the public informed even when the State Bank had reserves of only 600 million dollars, when these reserves rose to 2 billion, they were also made public. Before 11<sup>th</sup> September when the reserves shot up to 3.3 billion dollars, these

were also disclosed to the public. In fact we publish the foreign exchange reserves position in newspapers on weekly basis regularly. Further, I would like to mention here that in order to educate the people it is necessary to provide them detailed information. Earlier, we used to publish the figure of reserves held by the State Bank and those held by the banks as a combined single figure. We have now returned to banks their foreign currency deposits, so that no government, the present or future ones, fall prey to the temptation to freeze these accounts. After that the foreign exchange reserves were bifurcated into the reserves of the State Bank and the foreign currency deposits of the public held by the banks. Today, the country's reserves are of 5.3 billion dollars out of which 3.8 billion dollars are State Bank's own reserves and 1.8 billion dollars are of banks, which in fact are people's foreign currency deposits. We have now no control on foreign currency deposits of resident and non-resident Pakistanis, which are held by the banks. So, the actual figure of reserves held by the State Bank is 3.8 billion dollars. But compare these reserves figure with that of 600 million dollars in October 1999 and how they have improved/risen.

**Talat Hussain:**

Sir, you purchased dollars from the market.

**Governor:**

Let me tell you about the procedure of purchase of dollars from the market. You know that under a controlled exchange rate regime, the Central Bank enjoys the monopoly and all the reserves come to the State Bank. In April 2001, we abolished this system and introduced a free-floating exchange rate determined in an inter-bank market. In this system, all the inflows i.e. export earnings, remittances, private inflows and foreign direct investment come into this inter-bank market from where the importers, multinational corporations, airlines and shipping companies purchase dollars. When the dollars become surplus in the inter-bank market, these are purchased by the Central Bank. This practice is followed by the central banks throughout the world. In this way, we build up our reserves and improve our balance of payments position. But it may be pointed out that the State Bank purchases dollars from the open market only when there is a surplus of dollars in the market by paying a premium of one or two rupees. When the rupee begins to depreciate against the dollar, for example, when I notice the rate is going up from Rs.60 to Rs.62 per dollar, I do not purchase the dollars from the market in view of its higher demand.

**Talat Hussain:**

This is the work of the market and you are playing the role of a market.

**Governor:**

The State Bank is a regulator as well as the player of the market. This is a new concept in Pakistan but this practice was in vogue in other countries of the world. This concept was not in existence in Pakistan before April 2001. When you have a floating exchange rate, the Central Bank will have to go to the market to purchase the dollars. The State Bank also sells dollars to the market depending on the market needs. The sale and purchase of dollars is the work of the Central Bank. Now let me tell you about the purchase of dollars from the kerb market. The foreign exchange available in the kerb market is of our labour class, residing in Dubai, Abu Dhabi, Kuwait and Saudi Arabia. They send their foreign exchange earnings through 'hundi' because it is convenient for them as there are no cumbersome procedures involved and their money is transferred to any place in Pakistan within 24 hours. In such a way the dollars are available in the open market and can be purchased by any one. So, the State Bank was purchasing the surplus dollars from the kerb market. The only reason for the purchase of dollars from the open market was that we wanted to get rid ourselves of the debt trap. If I had continued to borrow from abroad, which has been the practice for the last 10 year, then our debt would have risen to 42 billion dollars instead of 38 billion at present and our debt servicing would have risen by 300 to 400 million dollars annually. What has happened by purchasing the dollars from the

open market is that we paid only two or two and a half rupees as premium over the official exchange rate. In fact, these dollars were remittances of our countrymen. After 11<sup>th</sup> September, all these dollars which were earlier coming to open market started pouring into the inter bank market because of the narrowing of gap between the kerb and the inter bank market rates. Moreover, due to strict vigilance on the activities of 'hundiwalas' in Dubai and Abu Dhabi and the improved performance of our banks, the remittances were now being routed through banking channels. The monthly remittances through banking channels have gone upto 220, 230 and 260 million dollars in contrast with 80 million dollars per month sometimes back.

**Talat Hussain:** Some people say that you are taking steps to regulate the hundi business under international pressure because Washington is monitoring undocumented money transactions in Dubai and Gulf region and some people say that even the FBI people are sitting in certain banks. So you have been compelled to take necessary measures to curb 'hundi' business.

**Governor:** It is an important healthy development that has taken place internationally. We cannot deny this that strict vigilance on 'hundi' business is being carried out in UAE & USA and we have

benefited from this action. But may I mention here that the work regarding the documentation of moneychangers and the setting up of the exchange companies has been in hand for the last two years. It may be recalled that we had put in place a code of conduct for the moneychangers in January 2001 so that they work under these parameters. We had also asked the small moneychangers to merge and set up big companies but when they did not pay any heed to our advice, we decided to establish Exchange Companies. Banks are monitored strictly. They are required to follow instructions regarding documentation and reporting, besides our inspectors conduct the inspection of Banks' branches. It is very difficult for us to regulate and monitor 4000 moneychangers. Therefore, we intend to set up 15 to 20 Exchange Companies. Just like banks, these companies will either have branches or retail outlets because we want to facilitate the common people. These Exchange Companies will be properly monitored. We will ensure that no undocumented transactions take place and these companies do no illegal work. Inshallah, these companies will go into operation by July this year.

**Talat Hussain:**

Now we move forward and talk about investment. You have reduced the lending rates. It was hoped that easy credit will be available to the private sector and credit will be picked up by the

private sector. But when we asked the representatives of the Chambers who came here in this very programme that why you people are not investing, although the credit is available on easy terms. They replied that the banks do not facilitate them in extending credit. When we talked to the bankers about it, they told us that the private sector people hesitate to come to us for credit. You were supposed to be facilitating in this regard by formulating a framework under which the investments would have picked up. But why this has not happened?

**Governor:**

In this connection, I would like to inform you that both the private sector and the bankers are right in what they are saying. I will explain to you how. When we brought down the discount rate by 4% from 13 to 9 percent during the last ten months, the businessman thought that the banks would follow suit and reduce their lending rate by 4 percentage point. Uptil now, the banks have reduced their lending rates by 2 and 2 ½ percentage points. So there is no one -to- one ratio between the discount and lending rates. The reason for this is that when the discount rate was raised by 4%, the lending rates of the banks had not risen by 4%. The banks' lending rates at that time had risen by 2 to 2 ½ per cent. The increase or decrease in lending rates does not take place in proportionate manner with State Bank's discount rate. Further, as

you are aware that the three major banks viz. NBP, HBP, UBL have 60% market shares but their old non-performing loans are on a very high side. When you have such a large scale of non-performing loans then you have to pay the price because banks do not earn on these NPLs and the spread between the lending and deposits rates go up. When we will privatize these banks and they would no longer remain in Government control, they will have competition amongst them and they will have lower volume of non-performing loans, their lending rates will go down further. Another problem with the banks was that they had to pay 58% income tax whereas Corporations pay only 35% income tax. We have brought down the income tax on banks to 50% and Inshallah we will bring this down to 35% in the next two or three years. The burden of tax affects the lending rates also. As far as bankers are concerned, they say that they lend to their prime borrowers whose credit rating is good and with whom they are doing business for a long time, at 8% interest, which is the Government rate. But for a new and small and medium entrepreneur having no collateral and security and who can not generate sufficient cash flows to return bank's credits, he is given loans at a higher lending rates. To resolve this problem, the Government has set up agencies such as SMEDA to help the small and medium entrepreneurs. We are softening the State Bank regulations for such institutions. The

regulations that are applied to big corporations should not be applied to small and medium enterprises. We recognize that it is not possible for a small depositor or a small entrepreneur to produce three years Audited Accounts, when they do not have such accounts. We have already established an SME Bank. Habib Bank has dedicated its 21 branches for small and medium entrepreneurs and we will take the SME sector forward.

**Talat Hussain:**

Dr. Saheb! There is no doubt that growth will really pick up only when there will be huge investments on sustainable basis. Your technical reasons regarding the non-picking up of growth rate are also valid. But according to some people, bankers are reluctant to sanction loans because granting of loan has now been equated with crime. There is a lack of confidence among the businessmen. In this very programme, a businessman had said that he did not know what would happen in future. He also talked about political instability, although Government's assurances are available. Technical reasons apart, how can growth will take place in a situation when the lender is reluctant to advance loans and the borrower is also hesitant to borrow?

**Governor:**

You are right. There is a truth in this assertion. This situation was created when the NAB started arresting both the bankers and the

businessmen. This action not only shattered the confidence of the people but also affected the investment climate. It was for this reason that the President made an amendment in the NAB Ordinance, which authorized the State Bank Governor to decide whether a loan default was a willful default or a circumstantial default. For this, we have chalked out criteria according to which if a person who has taken a loan of rupees one million and instead of repaying this loan, he is spending Rs. five or ten million monthly, it clearly shows that he is a willful defaulter and he does not want to repay his loan. However, if someone's consignment reaches the sea-port and at this point of time he comes to know that the duty on his consignment has been raised from twenty per cent to thirty percent, then in that situation the poor fellow would not be able to pay the duties and get his consignment released. Naturally, he cannot repay his loans to his bank. This is a circumstantial default. So, we have deleted the circumstantial default from the NAB Ordinance.

**Talat Hussain:** Governor Saheb, tell us about its impact.

**Governor:** Very few people have been referred to NAB since the introduction of this law. But the people, whether they are bankers or businessmen, are still afraid of what had happened earlier. We

want to prove with our actions. If a default has taken place due to circumstantial reasons then there should be no cause for concern for both the bankers and the businessman, though lending is a risk taking business.

**Talat Hussain:** We were talking about the banking sector and now let us talk about the banking reforms. Besides having various frame-works of International Monetary Fund with us we are also working on the subject. Are you satisfied with the situation of the banking sector in Pakistan? Whether some new banks will be closed down or not?

**Governor:** These are two different things. As a regulator, it is my duty to ensure that your deposits are safe, sound and secured. If it comes to my notice that bank 'A' has wrongly utilized your funds, then this is my duty to take action against that bank and cancel its licence. In the last 2 – 2 ½ years, I have without any hesitation cancelled licenses, changed managements, effected mergers, issued notices and suspended the Board of Directors of banks. NAB has also taken action against the Directors of the banks. The only purpose of these actions was to warn others that action would be taken against them, if they misuse the funds of the depositors.

**Talat Hussain:** You have closed down three banks?

**Governor:** Yes. We have closed down three banks.

**Talat Hussain:** Some people say that if the State Bank had taken timely corrective measures, then there would have been no need to close down these banks. That was the option of the last resort. Why did you allow the situation to drag to such an extent?

**Governor:** There are two aspects involved in your question. I think that we should give importance to prescribed procedures and follow the due process of law. In this country, no person including the State Bank Governor should enjoy the discretionary powers to take arbitrary actions. In the Banking Companies Ordinance, there is a complete procedure prescribed for taking action against the banks. First we investigate, then form a statutory committee, afterwards issue a show-cause notice, after the show cause, an inquiry into the matter is conducted. If the banker is not satisfied with the inquiry, he is then provided a second chance. Thereafter his case is referred to the court of law.

**Talat Hussain:** No matter the accounts of the depositors are affected during this process?

**Governor:** No. We freeze the activities of the banks but the question of the confidence of depositors is also important so that they may not take out their deposits from the banks. On the one hand, you have to keep a watch on the activities of the banks and on the other hand you have to prevent a run on the bank. This is a very difficult task. But I am of the view that the state of affairs cannot be improved until and unless we strictly follow the rule of law. I would like to mention here that there might have been some delay in taking action against banks and I take full responsibility of it, but I have

provided complete opportunity to every bank against which action had been taken to defend its case. No action has been taken against any bank without listening to its point of view.

**Talat Hussain:**

We were talking about banking reforms. Let us talk about State Bank's internal affairs. You have introduced various reforms in the State Bank and set up a subsidiary. What is that all about? Tell our viewers about these reforms so that we can ask more questions on the issue?

**Governor:**

There are four major functions of a Central Bank. One of these functions is the supervision of banks, the second is the reserve management, the third is the formulation of monetary policy with a view to keep the inflation rate low so that the purchasing power of the people is maintained, and the fourth function is to regulate the payment system to ensure that an issued cheque is honoured anywhere in Pakistan. We have sixteen branches all over Pakistan. Over the last fifty years, these branches were entrusted with different tasks, such as exchange of mutilated currency notes with new ones, sale of Prize Bonds, receipt of challans etc. These work do not come under the purview of the core functions of the Central Bank. This work should be done but what was happening that eight thousand employees of the State Bank in sixteen cities of Pakistan were engaged in such kind of activities and only 1200 people were performing the core functions of the central bank. In such a situation my colleagues' attention and mine was primarily remained focused on the problems of the public and we were unable to pay more attention to the core functions of the Central Bank. This state of affairs might have caused certain delays in taking action against the banks as you have earlier pointed out. So we decided to focus our full attention on the main functions of the

central bank and set up an autonomous and independent organization to carry out the non-core functions of the Bank. A Managing Director who monitors the day-to-day operations of the Subsidiary heads this organization. We have common Board of Directors, which oversees the policies of both the Central Bank and the Subsidiary. By creating the Subsidiary, we have been able to focus our attention on core functions of the Central Bank.

**Talat Hussain:** At present, how many people have been deployed on core and public dealing functions?

**Governor:** Presently, 1200 people, all in Karachi, are performing the core functions of the Bank and about 6200 employees are working in sixteen branches throughout the country and in the head office of the Subsidiary, which is located in Karachi.

**Talat Hussain:** Before bifurcation, the number of employees performing the core functions was 1200. Then what's difference?

**Governor:** No. The number of employees in both the Central Bank and the Subsidiary has been reduced. I think nearly one thousand employees have been reduced during the last three years. As I had no intention to compulsorily retire the employees of the Bank we offered them an option of voluntarily separation or early retirement scheme.

**Talat Hussain:** So you are offering an option to the employees to either remain in the Bank or leave it?

**Governor:** Yes.

**Talat Hussain:** Let me ask you a provocative question. It is being said that after the internal reforms, new appointments have been made in the State Bank. Though it is a good move to bring in new people yet it is said that the pay package offered to these people were really on a very high side. They were given price out of market. And those who had worked in the State Bank for the last 20 – 25 years and brought the Bank to reach at a position where this institution after becoming an autonomous body in 1997, is now regulating the economy of the country, are being offered some money and told ‘Thank you very much, your services are no more required.’

**Governor:** I am really glad that you asked me this question because it gives me an opportunity to clarify the position. We have a pay structure for every grade, which is approved by our Board. So even if I appoint a person from outside, he too will get the same salary and perks, which are available to the internal employees of the Bank in the same grade. What is the cause of misunderstanding among the people is regarding some projects of World Bank and ADB. As you know that earlier we used to pay hundreds and thousands of dollars to a white skinned foreigner despite the fact that he did not know much about Pakistan. Now, we have some Pakistanis with international experience. When such people come to Pakistan on half the salary as compared to a white skinned foreigner, this causes resentment among the people. We have inducted three or four persons in the State Bank under the World Bank /ADB projects. One is a lady, who has been called from Malaysia. She has worked with Bank Negara. We have also acquired the services of one or two Pakistanis, who were working in the World Bank. These are three or four persons but they have contributed a lot in improving the working of the State Bank. They have completely

changed our training programmes and Human Resources Policy. People don't count the benefits we have gained by inducting these people instead they look at the cost. If we had acquired the services of a white skinned foreigner, we would have paid him four times more than what we are paying to our own people. This foreigner would have taken more or less a year to understand the State Bank and Pakistan. Please look at the efficiency and productivity of these people. If I have brought in four or five persons as advisers, they are helping us in moving the State Bank forward.

**Talat Hussain:**

Doctor Saheb! There are number of questions to be asked but due to time constraint, let me ask you a question regarding the role of the State Bank. As you have said, the State Bank is effective in whichever sector it is operating such as exchange rates and foreign exchange reserves. But as far as State Bank's role in the overall economy is concerned, a general impression is that despite autonomy, despite you intend to make the State Bank potent. Economic Managers do not take the State Bank seriously for real direction in the economy. They listen to you but they don't implement what you say. What do you say?

**Governor:**

I am of the view that the situation had already changed in 1997 much before my joining the State Bank. The pre-1997 caricature of the State Bank you were mentioning is right. The State Bank was an attached department of the Ministry of Finance, which had to comply with its orders. It got autonomy in 1997 and autonomy is linked with responsibility. When you do not execute your autonomy with responsibility, you lose your autonomy. You have to develop your human resources, strengthen your business

procedures, and take corrective measures to improve your information management system. Until and unless you take these measures, you cannot enjoy your autonomy. The purpose of this internal restructuring is to achieve these objectives. We will automate our manual processes. If we get the information from banks in real time, we will be able to early detect which bank is a problem bank. Our people would be able to effectively and efficiently supervise the banks and would come to know six months earlier whether a bank is heading towards bankruptcy or not. We will manage our reserves in such a way that if at present we are getting three per cent return, then we will be able to get six per cent return on these reserves. When the State Bank will take these actions, then the economy will move but it will take time. You cannot expect a change over night.

**Talat Hussain:**

Thank you Dr. Ishrat Husain, Governor, State Bank of Pakistan for gracing this programme with your presence.