

PAKISTAN STATE OF THE ECONOMY

PRESS CONFERENCE

An IPS Report

3 April 1986

PROF. KHURSHID AHMAD



PAKISTAN STATE OF THE ECONOMY

Prof. khurshid Ahmad

The economic history of Pakistan clearly reflects that the economy has done fairly well in terms of growth. With the planned development starting in 1955, the economy started gaining momentum and by the end of 1960s it had gained a respectable annual growth rate of above 6 per cent. Though it stagnated in general during 1971-77, yet it demonstrated a remarkable amount of resilience when its growth picked up during 1977-85. Anyhow, it will be unfair to blame the stagnation upon the policies of the then regime. To a large extent, the slackness was the result of adverse performance of the agriculture sector owing to floods, drought and other vagaries of the nature.

At the time of Independence the economy was characterized by glaring inequalities of income. Despite a respectable growth performance, there was created no significant dent into income inequalities and a considerable part of population, continued to live in poverty. There existed a lot of disguised unemployment.

Industrial sector has no doubt shown a respectable growth, but the credit goes mostly the protective umbrella under which it operated hence it makes its efficiency and competitiveness doubtful. A good part of the industrial sector lacks modernization. The textile industry which did quite well in the early period almost collapsed in the seventies and is still in difficulties. Export of manufactured goods continues to be heavily concentrated on a few traditional items. Pakistan has not been able to capture a good market of even garments which has been gainfully exploited by many other developing countries, particularly in the Asian region.

The development strategy adopted by Pakistan led_ the country to increasing dependence on foreign aid. Heavy reliance on PL-480 adversely affected the agriculture sector of the economy. Committed and outstanding external debt by the end of June, 1984 amounted to Dollars 12.9 billion. During 1972-73, the external resources accounted for 16.7 per cent of the total investment in the economy and the ratio increased to 32.1 per cent in 1984-85. Debt servicing of the economy (including IMF and short-term borrowing) now accounts for 38 per cent of the exports of goods and services (excluding remittances). Despite the heavy infusion of foreign resources, our development strategy has failed to bring any substantial improvement in the life of the masses.

Though the country was created in the name of Islam, no effort for almost 40 years now was made to transform the economy to conform to the Islamic ideology. Successive plan documents failed to make even a reference to the Islamization of economy. Zakat and Ushr which play a pivotal role in the Islamic Economic system were never introduced in the country. Interest on the other hand was allowed to continue to be the back-bone of the financial system. After 1977, although some efforts were initiated to Islamize the economy yet the results achieved leave much to be desired. Of late, even some back-tracking is' in evidence. These thoughts some of them thoroughly depressing - were at the back of the mind when the working group started a series of discussions on a number of

prominent questions: Have we developed a viable structure of the economy. Has it acquired capacity to ensure a self-sustained growth and is it in a position to meet the international economic challenges. With a crumbling infra-structure and the persistently low domestic savings, is the economy not heading towards a serious crisis, with these questions, agitating their minds, there was a general realization that lack of participation of masses in the planning process does not give the population confidence in the planning exercises done by their policy-makers.

RECOMMENDATIONS

Having located some of the serious ailments our economy is suffering from and the administrative prevarications, the Group has made a number of recommendations in the hope the public will find in them a topic to give their thought to and the Government a guideline to act upon.

The Group's opinions are:

I) Planning and Management

Persistence of the same economic problems despite a long history of development planning in the country suggests that there has been something basically wrong in the entire system of development planning in the past. The greatest omission in the process has been the failure to involve the masses in the hard core of planning. Planning has proceeded mostly on macro basis which ignores the problems faced by the people. The Group feels strongly that the projects should be initiated at the local level.

Planning at local level should be nationally integrated and, to match the fulfillment of various needs with resource availability, the Plans should be finished through an interactive process. This will also greatly reduce the feeling of deprivation in different regions and will provide opportunities for participation of the masses in planned development.

The Group attaches highest importance to evolving an effective system of evaluation and monitoring of development projects to ensure that wastage of resources is avoided and scarce resources are put to more efficient use. The planning function should be separated from the evaluation and monitoring of development. An independent institution should be developed for this purpose. It would be highly fruitful if members of the Parliament are also involved in the monitoring and evaluation of projects.

II) Income Distribution

The Group noted that available data indicated a worsening of the income distribution pattern in the Seventies and felt that this process seems to have confirmed in the Eighties. In this connection, it was emphasized that Islam stands for social justice who entails an equitable income distribution as a necessary condition. The Group, therefore,

recommended that, in addition to the maximum harnessing of the systems of Ushr and Zakat and larger development outlays for improving the quality of life of the masses, the fiscal, monetary and all other relevant policies should be so devised as to give a high priority to the need for bringing about a more equitable household income distribution in the country. Of equal importance is the need to ensure through these policies a substantial improvement in the inter-regional and intra- regional income distribution.

III) **Employment Generation**

Statistics should be collected to provide a more accurate and comprehensive assessment of employment situation in the country. As an immediate step, the available statistics collected by different agencies should be organized properly. As a long-run measure, it is suggested that comprehensive Manpower Resource Surveys be organized by the Statistics Division to collect statistics on different aspects of the availability and uses of the human resources in the country rather than focusing simply on a narrow concept of labour force. The entire span of activities of the human resources is required to be covered along with a survey of the physical resources owned by these human resources.

A new approach towards employment strategy is urgently required. The past policies have failed to bring out any fruitful results. One direction in which we need to modify our employment strategy is to re-define our objective. The objective of our employment strategy should not be to create only wage-paid job opportunities but also to create an environment where the population in working-age can find productive opportunities of their own choice in their own neighborhood. This requires giving them an access to capital (financial or physical). The banking system should work out small projects which even a less educated but skilled person could handle to establish his own business. The banks should provide finance for such projects.

On the basis of Islamic financing techniques, one of the distinctive features of Islamic banking should be that it provides capital to the less privileged sections of the society. The banking system of the country, therefore, should play an important role in mobilizing human resources.

There are several elementary skills which require very little time and resources to acquire. For example skills like those of mason, carpenter, electrician, welder, plumber, auto-mechanic, tailor, etc. can be learnt even by an illiterate person in a period of about 12 months. All such skills are in great demand in the country. They are paid more than twice as much as the unskilled labour. Vocational Training Centers should be established throughout the country, and possibly linked with mass literacy campaign. For, it is a simple phenomenon that economic benefits promote literacy and literacy ensures economic benefits.

IV) Exchange Rate Policy

The Group observed that since the delinking of rupee from US dollars in January 1982, the effective exchange rate of Pakistan has deteriorated substantially. Despite this decline the export performance, did not, however, improve. In fact exports have declined in real terms since delinking.

While analyzing the underlying reasons for deteriorating export performance, the Group felt that the exchange rate is not exerting due influence on exports owing to high rate of monetary expansion in the economy which in turn is increasing the domestic absorption and reducing exportable surplus. This is also corroborated by sharp decline in savings rates in the economy during recent years.

The group felt concerned that a much greater reliance is placed on exchange rate mechanism to achieve equilibrium balance of payments than what is warranted by the general economic situation in the country. The continuous deterioration in exchange rate is exercising upward pressure on the prices of imported goods which is screwing up the domestic cost of production with its implication both for domestic consumers as well as for exporters' competitiveness abroad, It may also be mentioned that exchange rate deterioration is raising debt service obligations in Rupee fees. Furthermore the deteriorating exchange rate is not allowing passing on the price affect of recession abroad to the users of the imported goods in the economy.

The Group felt that remittances have already started declining owing to exogenous factors. The presence of continuous devaluation of currency gives an incentive to the migrants to postpone their remittances as far as possible. The decline in the exchange rate is, therefore, required to be arrested.

In the above context, the Group felt that rate of monetary expansion be reduced to relieve the burden on exchange rate for balance of payment equilibrium. At the same time, greater attention should be given to improve exports by increasing production along with improving the quality of production.

V) Domestic Resource Mobilization

The Group noted that the dependence of the country on external resources had increased sharply over time and needed to be reduced by making concerted efforts for maximization of Domestic Resource Mobilization.

On the basis of a careful analysis of the problem of domestic resource mobilization, the Group made the following recommendations:

- a) The mentality to be ostentatious in consumption should be curbed by simple living in circles that are expected to set an example. It is ironic that while runaway spending was once frowned upon as a vulgarity in Muslim society, few now bother about the legitimacy of the source that sustains that vulgarity. Change may not be visible straightaway. Nevertheless the task if delayed will become increasingly difficult. The vice has already struck firm root.
- b) The taxation system should be used to curb the tendency for conspicuous consumption. Consideration should be given to changes both in the system of direct and indirect taxation. At the same time incentives should be built in to promote savings and capital formation,
- c) The Islamization of financial system should be used to provide fruitful avenues of investment of savings in Islamically legitimate ways.
- d) A thorough scrutiny should be carried out of non-development expenditure of the Government to reduce the absorption of resources for less essential purposes and to release resources for development.
- e) The potential of public enterprises to generate additional resources should be utilized by giving greater freedom for the management of these enterprises to the administration of their projects and by giving work incentives to their workers.

VI) **Monetary and Banking Sector**

The Group observed that during the past many years the rate of monetary expansion has been far in excess of the real GDP growth rate, which has been exerting upward pressure on prices. Figure for the first half of the current year also shows that the same trend is, continuing. The high rates of monetary expansion were caused by both sizeable deficit financing and credit expansion in the private sector. Most, of the borrowings of the private sector were against inventories, which are against the development goal and allow the borrowers to release their own capital for investments yielding higher returns than the rates of interest payable to banks.

The Group recommended that the State Bank should take measures, such as imposition of high compulsory margin requirements and increase in existing margin requirements in the case of large borrowers who are in a position to so as to bring pressure on them to raise equity finance, reduce their excessive recourse to the banking system. This would also help reduce the concentration of credit in big account, which has been referred to above.

VII) **Agriculture Sector**

The system of support prices may be extended to the maximum number of commodities to stabilize their production and prices.

Area under certain crops, such as oilseeds and pulses should be increased by additional incentives. Dependence on imports of oilseeds should be minimized in the shortest possible period.

Urgent steps should be taken for controlling water losses. Canal water supply should be made regular and systematic.

Agricultural credit should be looked at as part of a household plan. It is impossible to place apart a household's consumption needs and production needs. They are linked together. A number of farmers' personal needs are genuine and have implications for the overall efficiency of the farm. The credit plan for a farm household must also allow for the marketing needs besides production needs. Also it should help them undertake non-agricultural productive activities in slack season.

VIII) Development of Social Sectors

The Group felt that it was high time that the development strategy of the country was so modified as to give much greater importance to the social sectors that it had traditionally been the case. It emphasized that the required improvement in the quality of life of the people could not be achieved unless the share of social sectors in the small development outlays was substantially increased. The Group, therefore, recommended that in order to bring about a visible improvement in the quality of life of the masses adequate resources should be provided for the development of the social sectors. Higher priority should be given to the supply of clean drinking water, better facilities for power connections and low-cost houses. In this respect the Group specifically recommended the following:

a) Development of Social Sectors

Education: The main hurdle in the way of mass education is the scarcity of trained teachers. Merely employing the unemployed to eliminate illiteracy is no answer to the problem. They shall have to be suitably trained in the trade. A corps of trained teachers, appropriately motivated and attuned to the task is required to be promoted to achieve the objective. Mosques, which can play an important role in raising the literacy ratio but have not yet been utilized adequately, should also be made full use of in promoting literacy.

Cost of education is to be assessed at each level and should be linked with productivity to provide a basis for educational as well as manpower planning.

Health: Since there is surplus supply of qualified doctors, their gainful employment can be achieved by promoting health services in the private sector for which finance on the basis of Mudaraba may be provided by the financial institutions.

Housing: House is a basic human need to which higher priority ought to be attached in development plans. The tendency to reduce bank credit for housing when resources squeeze must be firmly discouraged and measures taken to increase the availability of bank credit. Owing to rise in cost of building material the present system of financing needs should be replaced by the more liberal two-generational financial scheme adopted by some foreign countries. Provision of larger credit for housing will also serve as a device for promoting more savings in the long run.

IX) Building up the Infra-structure

The Group noted long that the physical infra-structure has long been neglected and is crumbling. Increased attention, therefore needs be given not only from the point of view of developing a new infra-structure but also for the proper maintaining the existing one. For future viability of the economy, it was considered necessary that the share of infra-structure, its development and maintenance - should be substantially increased in the total plan outlays. In addition, the Group made following specific recommendations:

- a) **Transport System:** We require a much more efficient road network. All the inputs for this are available within the economy, except Asphalt. Since the public sector has not proved a much success and the roads continue to be both ill-planned and ill-constructed, private sector may be entrusted to build up dual carriage roads. An efficient road system will save on the oil import bill also. Vehicles will enjoy a longer life thus cutting down the import of spare parts.
- b) **Energy:** To meet the deep seated crisis in the energy sector, both short-term and long-term measures are required.

Under the short-term plan, one way could possibly be to allow import of fuel oil free of duty. Fuel oil, thus imported should not be misused. It can be used only to generate energy. Its free import, therefore, will not only reduce the cost of production for domestic consumers but will also enhance the export competitiveness.

For the longer run, attention should be paid to develop hydro-electric power not only through large dams but also through small dams as in China. Coal should also be used to the extent possible. Coal should particularly be used for power

generation in Baluchistan. For this purpose small 5 to 10 megawatt power generating units can be used specially to exploit underground water resources of Baluchistan.

There are coal resources in NWFP too which also should be exploited.

X) Management Improvements

Following recommendations were made:

- a) Re-dedication to the concept of merit and competition at all levels in admissions as well as recruitment.
- b) Special emphasis on management education and training and development of professional managers.
- c) Effective training of Bank Managers and executives in Asset Management in the context of implementing the Islamic system of banking.
- d) Management of public sector enterprise should be entrusted to train managers instead of generalists.
- e) Unrestrained mobility and transfer should be stopped and people should be stabilized in particular careers to acquire professional expertise and deeper insight.
- f) Management techniques should be modernized through use of computers and modern technology.

XI) Islamization of Economy

The Group underlined the fact that Zakat and Ushr are not only an ibadah (a religious ritual) but also a means to social security. It is, therefore, necessary that they are fully utilized to provide a relief to mass poverty. The Group, therefore, recommended that the coverage of the 'Zahira' assets should be expanded to bring them fully in line with Shariah. The existing machinery for collection and distribution of Zakat should also be re-examined and appropriately toned up.

Having proclaimed to the world that Pakistan is introducing an interest-free system which is superior to the interest based system; it is incumbent on us to bring about a really basic transformation in the existing system fully in line with the Shariah. In this context, the Group emphasized that the ideal Islamic substitute for interest is the system of profit/loss sharing based on the principles of Musharaka and Mudharaba which are unanimously

regarded as fully in line with the ethos of socio-economic value system of Islam and can be a source of blessings by bringing about a marked improvement in a locative efficiency and distributive justice. The system of profit/loss sharing should, therefore, be given the most predominant position in the entire financial system of the country.

PROF KHURSHID AHMAD