

## **Ishrat Husain: The role of the private sector and government in Pakistan's economic development**

Convocation address by Dr Ishrat Husain, Governor of the State Bank of Pakistan, at the Institute of Business Management, Bahauddin Zakariya University, Multan, 4 February 2003.

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Mr. Vice Chancellor, Dean of Faculty, Director IBM, Distinguished guests, Faculty members and dear students,

I would like to thank the Vice Chancellor, Faculty of the Dean and Director of the Institute of Business Management for inviting me this evening at their graduation ceremony. I would extend my sincere felicitations to all those who will receive their M.B.A. degrees today and also to their parents. As an employer who recruits about 50 candidates from among several thousand applicants through a competitive process every year I am quite sure to see some of you in the State Bank of Pakistan in near future. We already have more than 50 graduates from this University and the Institute and they have demonstrated high standards of integrity and professional competence. As your Director has pointed out some of the able graduates of this Institute are unable to cross the threshold of 70 percent marks at the M.B.A. examination used by the S.B.P. to screen the candidates because of your rigorous grading. But you must realize that we receive 11,000 applications every year and it is not possible for us to test all of them. Hence we have to adopt a certain cut-off point. We would examine other possibilities such as ranking of the Universities and Business Institutes to adopt alternative system of screening.

Today, as it is a tradition on such occasions I am going to address on an important topic i.e. the role of private sector in the economic development of Pakistan. Most of you will end up in this sector and I would therefore like to give you some advice – as to what role you should play.

Pakistan has made considerable progress during the last 55 years since its independence. A country with about 30 million people in 1947 was heavily dependent on imported food, imported cloth and imported energy to sustain itself. There were serious doubts raised at that time about the country's economic survival. Today, in 2003 Pakistan one of the largest countries in the world with a population 145 million is not only self sufficient in food grains, meat, milk and poultry but also exports wheat and rice. Pakistan does not only clothe its population but is one of the leading exporters of textiles in the world. More than 50 percent of the energy needs of the country are met from local reserves of natural gas and hydel power. Pakistan was one of the few developing countries that achieved an impressive economic growth of 6 percent annually for over four decades and tripled its per capita income. Incidence of poverty had declined from almost 50 percent of the population to less than 20 percent by the late eighties although it has resurged to 34 percent by the late nineties. An average Pakistani today has higher life expectancy, enjoys higher food per capita and consumes more calories than his father's generation. We have built large dams such as Tarbela and Mangla, motorways, super highways and modern ports. We are better connected to the rest of the world through fast means of telecommunications, internet, cable and satellite channels.

Despite these spectacular achievements for which we should thank Almighty Allah for His blessings we are still a poor and underdeveloped country and the benefits of this progress have not been shared universally. Too many people have been left out: One-third of the population still lives on about Rs.60 per day, one-half of the population is illiterate with extremely low female literacy rates in the rural areas, a large segment of population does not have access to safe water for drinking and personal hygiene; disease, malnutrition, infant and maternal mortality rates are still quite high, population is growing more rapidly than other countries in the region and income and regional inequalities are rising. In essence, we have lagged behind in our social and human development indicators and our performance has been much below our potential. This lack of social progress has also created problem of social cohesion. This therefore, brings me to a series of questions: How can we catch up with the rest of the world and start improving on our social and human development indicators? What can we learn from our own historical experience and the mistakes we have made in the last? What can we extract from the success stories of other developing countries and apply them to Pakistan? Although there is always a lack of unanimity among economists about the prescriptive aspects of development let me venture to share my own thoughts with you today.

The last five decades of development experience have taught us clearly that the respective roles of the Government and private sector should be clearly delineated, defined and put into practice. Those who think in terms of dichotomy between market and government are sadly mistaken. Government has the primary responsibility to (a) provide security – internal and external to its citizens (b) maintain law and order (c) dispense quick and fair justice and enforce contracts (d) build physical infrastructure (e) provide basic social services such as education, health and water supply (f) implement good governance (g) maintain macro economic stability, (h) regulate the markets where there are monopolies, externalities, economies of scale (i) build social safety nets for the poorest and vulnerable segments of the population. Markets need government and government needs markets. The state is not a substitute for the market but a critical complement and that Government action is essential to ensure that development process is inclusive and the benefits of growth are not pre-empted by a small class of elite in the country.

Private sector, on the other hand, has the capacity and ability to produce, distribute and trade goods and services in the economy efficiently and at least cost. There is hardly any justification for the Government or the bureaucrats to be running businesses. The record of public sector enterprises and nationalized commercial banks in Pakistan for the last 30 years speaks volume of the damage that has been inflicted on our economy. To just give you one example, if 50 percent of the allocation of Rs.100 billion which was made last year to bear the losses of the public sector corporations and enterprises was diverted to education, health and other social services, imagine how much it would have helped the common man in this country. Profit making is not dirty provided it is made through competition, hard work, entrepreneurship, in an environment where there is a level playing field for all economic sectors, where the rules of game are applicable to every one, where implementation of policies and regulations take place across board, where taxes and other government dues are paid on time and loans are repaid without any write off. Under such circumstances private enterprises generate production, employment, opportunities and create income in the economy. This will only happen when they make profits and invest those profits in expansion of their existing businesses or creating new businesses. Economic growth takes place through this investment, incomes rise and the countries get prosperous. Those of you who still believe in old socialistic ways of thinking in which profits were condemned as socially exploitative should shed this thinking as this is flawed and empirically incorrect. Privatization, Deregulation and liberalization are the key instruments through which private sector can flourish and thrive. Those of you who believe that Governments should create jobs for all educated youth are sadly mistaken as it only burdens the Government budget with artificially inflated and unsustainable, wasteful expenditures and results in larger fiscal deficits. These deficits can only be financed through borrowing or printing currency. If the former route is taken then we are caught in a debt trap and if the latter route is adopted we are in any inflationary bind. Both of these routes lead us to a path of disaster and instability for the economy.

You must realize that the private sector employs 90 percent of the labor force in Pakistan and Public sector hardly 10 percent. Private sector is thus not only the main engine of growth but also the main provider of economic opportunity and activity. 60 percent of the country's labor force is employed in agriculture through tenancy, self-employment, owner-cultivated land or farm and non-farm labor. 80 percent of the non-agricultural labor force depends on small and medium enterprises including small shops, hawkers, thela wallas, hotels and restaurants, social and personal services, construction, transport services. Only 20 percent of non-agricultural labor force is employed in organized sectors in Government, manufacturing, electricity, gas and water, financial institutions and other services. Thus private sector growth, particularly of smaller firms and farms, is vital to both employment generation as well as reduction of poverty in Pakistan.

How can the private sector, particularly small and medium enterprises and agriculture be encouraged to expand, invest and generate employment? First and foremost, good economic governance must prevail and be practiced. Unless there is transparency, predictability, consistency, rule of law and uniform application of law, private sector would not be forthcoming as the uncertainties in economic governance do not allow them to make accurate calculations of their costs and benefits. Bureaucratic harassment, corruption and extortion are all damaging to the investment climate as they impose barriers to entry, add to operating costs and create uncertainty once the firm is established.

Second, there should be sound economic policies in place – fiscal discipline, market determined exchange and interest rates, lower trade barriers and tariffs, reasonable taxation levels, openness to trade, and well functioning financial system. In absence of sound, clear and consistent economic policies the private entrepreneur will always be reluctant to part with his capital. Unsustainable fiscal

policies crowd out private sector and make it more difficult for them to access credit from financial system at reasonable price.

Third, changes in political regime should not create abrupt and radical shifts in the underlying rules of game. Contracts and projects approved by the preceding governments should be scrupulously honored by the subsequent governments without any interruption or hiatus. Commercial disputes or allegations of corruption should be tackled according to the due process of law and arbitration procedures. Whims and caprices of individuals should not be allowed to play havoc as they not only undermine the confidence of existing firms but also deter new investors from engaging in production.

Fourth, the Government has to ensure that physical infrastructure and adequately trained and educated labor force are available in sufficient quantities so that the private firms derive benefits from reduced cost of production. If electricity or water charges are exorbitant, transportation costs are overbearing or the educational level of labor is quite low the returns to prospective investment are considerably reduced and the investor is unwilling to commit his funds.

Fifth, adequate credit availability from financial institutions to agriculture and SME sectors has been one of the major constraints for growth. The SBP has taken measures recently to accelerate credit delivery to these sectors by involving commercial banks on a large scale and giving them incentives. Prudential regulations are also being revised to remove the hurdles in the way of credit delivery to small and medium enterprises. The multiplier effect on the economy through higher credit and enlarged access to the economic actors in these two fields is likely to be quite large and sustainable. As both these sectors are labor intensive they would generate a greater demand for labor absorption. China was able to reduce rural poverty from 250 million people in 1978 to about 34 million in 1999 by focusing on agriculture and Town and Village enterprises (TVEs). There is no reason as to why we cannot succeed in achieving the same results over the coming decade.

But, in facilitating the private sector to play the role we have outlined above I come back to the need for investing in education and training at all levels – higher, secondary, vocational and primary. It is not only the quantity that matters but also the quality of education. At this point I must commend the faculty and students of Bahauddin Zakaria University for maintaining high standards of education. I am confident that the students graduating from this University will be highly competitive and earn the respect of employers. These days, the reputation of institutions matters a lot and this reputation can not be acquired overnight. It is also not the buildings and infrastructure which contribute to this reputation but the curriculum, instruction, assimilation of knowledge, and its application to day to day life, problem solving approach which distinguishes one institution from the other. It is also easy to lose reputation although more difficult to acquire it. Therefore I will appeal to the faculty as well as students of this august university not to become complacent but remain on their toes. They should continually try to excel in their respective fields, maintain high standards and traditions of knowledge seeking and discourage the bad habits of memorizing the material, cheating at the exams, skipping the classes, selecting only the material which is likely to appear at the exam. Those of you who devote themselves to continuous and inquisitive learning will come ahead in life. No amount of sifarish or nepotism or connections with the right people will help you in the long run. It is only the innate qualities of hard work and systematic learning which will keep you in good stead. I wish all those who are graduating today the best of luck in their careers.