

Ishrat Husain: Distributing benefits of growth to the majority

Presidential address by Mr Ishrat Husain, Governor of the State Bank of Pakistan, at the pre-budget seminar held by the Pakistan Observer, Islamabad, 28 May 2005.

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The major recurring themes in the popular discussion on the economy have been shifting over the last six years. In the earlier years of the Musharraf period it was widely believed that the country was going to default on its external obligations. When this did not happen there was a loud consensus that Pakistan would not be able to comply with the stringent conditionalities of the IMF and would, sooner or later, get off the track. Since the country successfully completed the programme, the concern was raised that we had emphasized too much on macroeconomic stabilization such as large foreign exchange reserves while growth rates remained quite weak. Now that the growth rates have risen consecutively for the last three years, there is an anxiety that the benefits of growth are confined to a small minority of the population and are not being shared widely.

It should be admitted at the outset that the incidence of poverty in the country is quite high i.e. almost one-third of the population is living below the poverty line and unemployment and underemployment levels are also high, particularly among the urban educated youth. But, it must be realized that there is a well established empirical regularity in economic development – whenever economic growth rates are low, poverty and unemployment are high. Conversely, whenever a country records high growth rate, there is a general tendency for the level of poverty and unemployment to decline. This is also borne out by the past economic history of Pakistan. For thirty years i.e. between 1960 and 1990 Pakistan's economic growth rate was an impressive 6 per cent per year and the incidence of poverty went down from 46 per cent to 18 per cent of the population. This happened at a time when there was no explicit policy emphasis on poverty targeted interventions and social indicators were not improving. But during the 1990s when the growth rate fell to 3 to 4 per cent per annum, poverty resurfaced and by the end of the decade it was up once again reaching 33 per cent. As the first three years of the present decade were devoted to putting the economy back on track after the crisis of 1998, growth rates remained low and poverty and unemployment remained high. It is only in the last three years that we have witnessed growth rates of 5.4 per cent, 6.6 per cent and more than 8 per cent. If growth remains on this trajectory and poverty targeted interventions including investment in human development are implemented, there is no doubt in my mind that we would once again see a reduction in poverty and decline in unemployment rates.

What is the basis of this assertion? Higher growth rate in real terms means that all households in the economy with the exception of those not in labour force or not fully employed receive higher incomes after adjusting for inflation. Of course, these higher incomes accrue in proportion to the assets held by different income groups. Top 20 per cent of the population receives almost 50 per cent of the national income. So they receive higher incomes than the bottom 20 per cent who get only 7 per cent of the national income. But still this segment of the population is recipient of additional income generated as a result of faster growth compared to a situation where growth is low or stagnant.

Higher incomes translate into increased demand for goods and services. This puts pressures on prices in the short run as there are too many people chasing a limited supply of goods and services. But higher prices also signal to the producers that there are shortages and they should enhance their production so that they can meet these shortages. To increase their production, they have to invest in new plants & machinery and employ more people. As more people find jobs, they are moved out of the ranks of unemployed and unemployment rates decline. As incomes accrue to these previously jobless or underemployed households they are lifted out of poverty and hence the incidence of poverty falls. This is exactly what happened in Pakistan until 1988/89 and that is what is happening at present.

Sixty per cent of our population relies on agriculture directly or indirectly. Those engaged in agriculture are not employed in the strict sense of terms as we think about employment in factories, firms, government departments, etc. In agriculture, higher incomes accrue to the landholders through higher output prices and higher productivity. Farm labour also benefits as the demand for their services also rises and poverty declines in rural areas too. Part of this income finds its way into demand for consumer goods. Manufacturers seeing this upsurge respond by first increasing utilization of existing capacity and then expanding capacity through new investment. That is why we have seen double digit growth in investment, manufacturing production and sales and high overall growth rate of GDP.

But it must also be admitted that poverty is not only a phenomenon of low incomes but that of powerlessness, state of helplessness and lack of access and opportunities. In Pakistan, literacy rate is about 50 per cent and there is a high correlation between poverty and literacy. Those who are poor are preponderantly illiterate. Therefore, intensified efforts for education and literacy will certainly help in alleviating poverty. The educational system which is usually leveler of incomes has created inequities in Pakistan. The children of the well-to-do families study in English Medium Schools go abroad for higher education and return to occupy high positions in the country. The children of the poor families remain illiterate or go to madrasah or attend Urdu Medium Schools and generally become clerks. This is not fair at all. We should have a system whereby those who are bright and talented but do not have means to attend the best educational institutions should be given scholarships by the government. It is gratifying to see that the talented students from backward areas of FATA have been able to get into the State Bank of Pakistan by dint of their merit and not sifarish.

Drop out rates in our educational system are extremely high, the quality is poor and the skills imparted at government schools and colleges are highly irrelevant to the demands of the economy. The output from such educational institutions is, therefore, relegated to the ranks of the unemployed. While the economy has serious shortages of technical and professional manpower, we have surplus of ordinary BAs and MAs who do not have employable skills. This imbalance is one of the major factors for high unemployment among the urban educated youth. Gulf States and Malaysia are also looking for engineers, architects, technicians, mechanics, para-medical staff, nurses, etc. but we do not have adequate numbers available in the country.

Access to health facilities is also highly differentiated and parallels the story of educational facilities. The government-run hospitals, clinics and dispensaries are in terrible shape, devoid of basic drugs and equipment. The doctors manning these facilities concentrate on private practice and are indifferent towards the patients from the poor households. The drugs supplied by the government for free distribution are sold in the market to earn private profits while private patients have to fend for themselves.

Access to thana, kutchery and tehsil is also heavily tilted against the poor. They have to either seek the assistance of an influential person or offer bribes to get redressal of their grievances. As most of the time they do not have adequate financial resources, they resort to the first option. They, therefore, fall in the trap of patron-client relationship or mai-bap relationship that makes them permanently subservient to the well-to-do and influentials of their areas. They lose their autonomy and the decisions are made on their behalf by these elite groups. This loss in autonomy is translated into electoral support at the time of the elections for this elite class. Thus, powerlessness and loss of autonomy perpetuate poverty even when incomes may rise in the short run.

This state of affairs will continue to prevail until we bring about major reforms in our institutions particularly Civil Service, Judiciary and Police. Their orientation and mind set have to change and their performance should be evaluated on the basis of their providing access to the poor and common citizens. In essence, it is a matter of good governance not only at the highest level but at all levels of the public institutions – legislature, judiciary and executive.

The legal system and financial rules in the bureaucracy are also highly complex and full of obfuscations. Even if some well-meaning top officials are committed to bringing about some changes, the administrative machinery down the hierarchy is so cumbersome and anachronistic and the financial rules are so outdated and restrictive that good policy intentions are seldom translated into action.

What is the way forward to end this powerlessness and lack of access of the poor?

Good governance should therefore start with a review of the structure, processes, practices and rules and regulations of our administrative machinery and then bring about revisions wherever required.

There are some positive changes that are taking place or are underway. Devolution to local governments, civil service reforms, police reforms and judicial reforms are being implemented and the sooner they take firm root the encumbrances on the poor of this country will be eased.

Media – both electronic and print – have become more vigilant. They should undertake more in-depth investigative reporting and expose the malpractices prevalent in the system and ensure that the poor have better access to delivery of public services and institutions.

Non-government and civil society organizations have become quite active in the fields of education and health care. Some of them are providing quality services without imposing severe financial burden

on the poor. Private-public partnership should be strengthened to scale up these activities whereby the government provides the facilities and finances while the private and not-for-profit sector delivers the services to the poor.

Financial system is one of the most potent instruments for creating wealth and distributing benefits of growth to the poor. As financial sector has been restructured and competition introduced, there is a broadening of access for their products and services. Agriculture credit, consumer financing, SME loans, mortgages and microfinance are becoming quite widespread and the number of borrowers from middle and poor classes is gradually increasing. Although the number of beneficiaries is still between 2 and 2.5 million household, the State Bank of Pakistan is committed to double this number in the next five years.

In addition, public accounts committees of the legislatures, independent regulatory agencies, the National Accountability Bureau, offices of the Auditor General of Pakistan, Chairman, Federal Public Service Commission, Wafaqi Mohtasib, Provincial Mohtasibs, Federal Tax Ombudsman and Banking Ombudsman are some of the elements that will improve governance in the country and take action against the misuse of office, misappropriation of funds, indulgence in corruption and also take actions for redressing the grievances of common people.

Conclusion:

The government has provided an enabling and conducive environment for growth of economic activities in the future and foundation has been laid which will result in economic prosperity and stability. In the short term, we have to fight against inflation because it has hit the lower income groups and fixed wage earners the most. It will take five to ten years of sustainable high growth rates of 6 per cent or above to bring the incidence of poverty down to 16-17 per cent from the present level and improve the standards of living of the majority of population. This is possible if the policies are consistent and continued, external environment remains favourable and there are no sanctions or discrimination against Pakistan, good governance is practised, institutions for delivery of basic services to the poor are devolved and strengthened but most important political stability is entrenched. All political parties should agree on a common agenda that economic policies would continue in the larger interest of the country whichever party comes to power. After all they are all agreed on the need for rapid economic growth, macroeconomic stability, poverty reduction, improvement in social indicators and prosperity for the majority of the population. Of course, there will be fine tuning, adjustments and adaptation during the course of implementation, but the vision and direction would remain unchanged.

China has set its path to economic progress as far back as 1980 and there have been changes in the leadership of the Party but the direction and policies have remained the same. They have proactively managed the policies in light of changing external and domestic conditions. We can all see the spectacular results China has achieved in reducing poverty and bringing prosperity to the majority of their population.

In Pakistan also, the policies have to be adjusted in the light of unforeseen or unanticipated events. When inflation was low, the benefits of financial sector reforms, liberalization and competition were passed on to the borrowers as a policy aimed at kick start of the economy. As inflationary pressures have intensified in the recent months, the higher interest rates will raise the rates of return to the bank depositors who have been suffering for the last four to five years. State Bank of Pakistan will do its best to bring inflation under control but is also requires supply-side interventions.

In the medium term, the agenda for reforms is quite tall but I am confident that honesty, hard work, straightforwardness can push the country and individuals forward.

Our own religion teaches us to help the poor and hungry residing in our neighbourhoods. Zakat system can transfer finances from the rich to the poor. If we follow these teachings of our religion we can provide stability to the social order and the future of the nation will become bright.