

APPRAISAL OF STABILISATION AND STRUCTURAL ADJUSTMENT PROGRAMME IN PAKISTAN

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Differing visions and perceptions exist about the term “structural adjustment”. For some, it is an obligatory passage, an indication of maturity which marks the induction of a nation into the new world economy. To others, it is a blunt instrument, employed by the world's richer nations to ensure that heavily-indebted countries continue to service their debts, and that emerging economies provide a ready market for goods and services from the richer countries. Perhaps the detractors of such programmes are influenced by the slowing down of growth that stabilisation measures initially entail.

This paper examines the experience of Pakistan with the programme for stabilisation and structural adjustment. Part one of the paper deals with the performance of Pakistan's economy in three decades (1960s - 1980s) and the emergence of imbalances which necessitated undertaking the adjustment programme. Part two focuses on Pakistan's experience with stabilisation and structural adjustment. The final part discusses the impact of the adjustment programme on Pakistan's economy and the lessons that can be drawn from Pakistan's experience with structural adjustment.

INTRODUCTION

Adjustment programmes comprise two components: stabilisation and structural adjustments. Stabilisation measures are typically short-term policy interventions to address the imbalances created by the twin deficits of the fiscal and current account deficits. These policies aim to limit money and credit growth, reduce fiscal deficit and, through correction in the exchange rate, restore external balance. Structural adjustment seeks to bring efficiencies in the economy and stimulate higher long-term growth through change in relative prices and incentives. Removal of distortions in the economy, usually created through administrative action, helps in efficient allocation of resources. Typically liberalising prices and elimination of subsidies are meant to enhance production incentives and foster growth. Liberalising of the financial sector seeks to expand financial intermediation. Quantitative trade

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restrictions are replaced with tariffs and control over trade and industry is deregulated to promote economic activity.

A wide variety of measures are commonly grouped under the term structural adjustment. Packages implemented in the early 1980s are quite different from those offered today, and the recipe for a country with an underlying robustness in the economy or a low level of indebtedness may not necessarily be the same as that for some of the toughest cases. Nevertheless, the most important common feature of a structural adjustment programme is that it sets in process changes in the economy's policy environment and reviews its economic structures. These programmes are almost always accompanied by structural adjustment loans from multilateral financial institutions which concomitantly impose a set of conditionalities to ensure that changes in national development policy and in the economic structures take place in a desired way.

PART ONE

1. MACRO ECONOMIC PERFORMANCE OF PAKISTAN DURING THREE DECADES (1960s - 1980s)

Pakistan's economic performance during the last three decades, though encouraging both in terms of growth rate and improved policy environment, has evoked criticism on account of its depressed social indicators. By the end of the 1960s, a decade of very high economic growth brought about by fundamental changes in industrial and agricultural productivity, a number of problems began to emerge which indicated that growth was not as firmly established as had been hoped. The economy grew at an average rate of 6.8% during the decade while the rate of inflation averaged a better than expected 3.0 per cent. However, by the end of the decade, the trade balance deteriorated to 6.7 per cent of the GDP reflecting the inherent weakness in the policy of import substitution pursued by the planners and the industrial structure that emerged as a result. The pattern of growth launched in the early 1960s was predicated on a protective environment for industry and on a high and continuing inflow of foreign assistance, but when these inflows were restricted in the period following the 1965 war with India, the economy had no adequate response. Overall investment declined from 22.8 per cent in 1964-65 to 15.8 per cent in 1969-70. Domestic resource mobilisation efforts fell short of requirements and the resource gap widened.

The 1970s witnessed a marked slowdown in economic activity, partly as a result of specific economic policies pursued domestically and partly as a result of large-scale changes in the international economic environment. The disturbed political situation in the late 1960s and the early 1970s caused a major setback to the economy. Expansionary monetary and fiscal policies followed by the new political leadership created inflationary pressures.

Nationalisation of a significant segment of the industry and of the entire financial system shattered investors' confidence. This profound shift in the domestic environment took place at a time of important changes in the world economy brought about by the slowing down of economic activity in the first half of the 1970s, changes in oil prices, world inflation and the subsequent emergence of recession affecting the demand and prices of exports from developing countries.

The combined effects of both the domestic and external factors were far-reaching. While during the decade real GDP grew at a fairly robust average rate of 4.8 per cent, this was far below the growth rate of 6.8 per cent per annum experienced in the sixties. Lack of fiscal and monetary discipline led to high budget deficit, rapid monetary expansion and double-digit inflation.

In the late 1970s, there was a change in the political dispensation. This enabled a review of the economic policies pursued by the previous leadership. A policy of decontrol and gradual deregulation was adopted which immediately paid dividends. The notable features during the 1980s were the high rates of economic growth averaging 6.5 per cent per annum for the decade accompanied by a moderate inflation of about 7.5 per cent. However, fiscal deficits remained high by international standards and saving rates remained low even by the standard of developing countries. Despite the Government's declared efforts to restrain public expenditure, the gap between revenue and expenditure continued to widen. During the decade, the budget deficit remained in the range of 6 to 8 per cent of GDP, peaking at 8.5 per cent in 1987-88. Over these years, Pakistan's budget deficit averaged nearly twice that of the Asian countries as a group. Almost 54 per cent of the deficit was financed by borrowing from non-banking sources, 24 per cent from external sources and the remaining 22 per cent from banking sources. The trade deficit throughout the decade was high, it being 10.5 per cent of GDP in the first half of the eighties. The current account helped by workers' remittances averaged 3.8 per cent of GDP for the decade.

2. STRUCTURAL WEAKNESS

Although Pakistan achieved respectable economic growth along with low inflation, structural weaknesses that needed to be addressed emerged by the end of the 1980s. There were large fiscal imbalances, vulnerability of the external account and distortions in domestic costs and prices. It was realised that if left uncorrected, these structural weaknesses would jeopardise the

prospects for sustained high growth, low inflation and external payments viability.

PART TWO

3. ADJUSTMENT PROGRAMME

Pakistan, like a number of other developing countries, responded to its structural weaknesses by undertaking adjustment programmes during the 1980s. The adjustment programmes undertaken by Pakistan passed through three Phases: First Phase (FY 88-93), Second Phase (FY 94-97) and the Third Phase (FY 97-2000).

3.1. First phase of structural adjustment (1988-93)

A comprehensive package of measures were implemented over a period of four fiscal years beginning July 1988 with the support of international financial institutions. The programme concentrated on several key policy areas that were critical to the achievement of macro-economic objectives and also initiated wide-ranging reforms in other sectors to improve efficiency and the growth potential of the economy. The first objective was to achieve macro-economic stability as a necessary condition for sustained growth. This was to be supplemented by structural reforms to enhance efficiency in the use of resources and to make them more productive. The priority structural measures included major fiscal reforms to broaden the tax base, a comprehensive programme of trade liberalisation, and deregulation of important costs and prices throughout the economy. In the external sector, the programme aimed at ensuring a sustainable current account deficit while substantially increasing the level of gross official reserves.

The programme emphasised specified targets to be achieved for the key macro-economic variables by its end in 1991-92. Real GDP was to grow by 6.2 per cent; the rates of national savings and of gross investment as percentage of GDP were to be 15.6 per cent and 19.0 per cent respectively, the budget deficit was to be reduced to 4.8 per cent of GDP; the money supply was targeted to grow at the rate of 12.9 per cent; the rate of inflation to 8.0 per cent; and the current account deficit at 3.4 per cent of GNP.

3.1.2. Achievements

In the first phase of the adjustment and reform efforts, which began in 1988, Pakistan made significant gains in structural reforms and improvement in the performance of key macro-economic variables. In spite of the possible dampening effects of stabilisation policies the economy continued to grow. As against an annual average growth rate of 6.5 per cent during 1981-88 (pre-

programme period), the real GDP grew at an average rate of 5.7 per cent p.a. during the programme period. Remarkable progress was made in the agricultural sector which grew by an average rate of 61 per cent as compared with 3.9 per cent during the pre-programme period. Although the manufacturing sector's performance did not improve in comparison with the pre-programme period, it is difficult to ascribe a reason to this as it could well have been on account of the political uncertainty and disturbed law and order situation in the major 'growth poles' of the country. Both national savings and investment rates improved as compared with the pre-reform period. They also surpassed the programme target by more than one percentage point of GDP.

The trade deficit registered remarkable improvement. As against an average deficit of 9.5 per cent of GDP, the trade deficit, on average, declined to 5.7 per cent of GDP during the programme period. The introduction of a flexible exchange rate policy coupled with enhanced cotton production were mainly responsible for reducing the trade gap. The performance of the current account deficit was not up to the mark. As against an average gap of 3.7 per cent during the pre-programme period, the current account deficit averaged 4.3 per cent during the programme period.

Correcting fiscal imbalances has proved to be an intractable problem for successive governments. Although attempts have been made on several occasions to reduce the deficit, any success achieved has been temporary and limited. Budget deficit averaged 7.0 per cent of the GDP during the pre-adjustment period but increased to 7.5 per cent during the programme period. On the revenue side, it is clear that the tax base remained limited which is quite evident from the stagnant tax-to-GDP ratio. On the expenditure side, total expenditure as percentage of GDP, instead of decreasing, increased from 24.6 per cent to 26.1 per cent during the programme period. Most of the increase came from current expenditure rather than from the much-needed development expenditure. The consequences of this were visible after the end of the first phase of the programme in the form of bottlenecks in vital components of the physical infrastructure like energy, transport, etc., and a visible lack of improvement in the social indicators of the country.

On the money and inflation front the outcome was disappointing. The growth of money supply averaged 16.0 per cent as against 14.4 per cent during the pre-programme period. More specifically, the monetary expansion reached an all-time high of 30.3 per cent in 1991-92 mainly due to the financing of large-scale deficit from bank borrowing. Higher monetary expenditure coupled with manifold increases in oil prices due to the Gulf war in 1990-91 accelerated the inflationary build-up. The rate of inflation reached a double-

digit level--much higher than the pre-programme period as well as higher than the programme target.

3.2. Second phase of structural adjustment (1994-97)

Pakistan intensified its medium-term adjustment and reforms programme in 1993-94 with the assistance of the IMF and the World Bank in response to rising inflationary pressures and deterioration in the current account deficit. Its efforts aimed to strengthen the country's external position, develop the supply side of the economy, reduce vulnerability to external shocks, and improve its social indicators.

Pakistan's adjustment efforts during the second phase were aimed at achieving certain key macro-economics objectives which are given as follows:

- i) sustaining annual economic growth at about 6.5 per cent;
- ii) reducing inflation from 9.3 per cent in 1992-93 to 5 per cent by the end of the programme period;
- iii) Raising gross official reserves to about three months of imports;
- iv) reducing the burden of domestic and external debt;
- v) a large reduction in the budget deficit, preferably close to 3 per cent of GDP by the end of the programme;
- vi) gradually increasing total investment and national savings rates to 22.1 per cent and 20.5 per cent by the end of the programme period respectively;
- vii) reducing the current account deficit to 1.5 per cent of the GDP by the end of the programme period;
- viii) Sustaining monetary expansion at about 12 per cent.

The macro-economic targets were to be supplemented by accelerating the pace of structural reforms in areas such as tax and tariff reforms; financial sector reforms; further liberalisation of exchange and payments regime that include removal of restrictions on current international payments; accelerating the pace of privatisation along with the opening up of new activities (such as utilities and insurance) to the private sector; further simplification of the investment regime; the removal of the remaining price distortions; and improving the social safety net through reinforcing efforts in the Social Action Programme.

3.2.1. Achievements

The results achieved during this second phase of the programme were mixed. Some macro-economic variables showed some improvement. From a high of 8 per cent of GDP in 1992-93, the budget deficit declined to 5.5 per cent of GDP in 1994-95--a significant achievement. The share of total Government expenditure as a percentage of GDP declined.

The external sector performed well during the year 1994-95 as exports grew by around 18 per cent in dollar terms though imports also picked up sharply by 16 per cent. Remittances exceeded the target and the current account deficit halved in two years. As a result, the foreign exchange reserves increased to \$2743 million at the end of the year, sufficient to finance about 3 months' imports, as agreed with the IMF. Growth in real GDP remained below programme targets. It declined to 5.2 per cent while inflation climbed to 13 per cent.

On account of non-compliance with certain performance criteria, the ESAF/EFF programmes were changed into a Standby Arrangement (SBA) of \$600 million in December 1995. The newly-prescribed targets under SBA, however, were less ambitious. The fiscal deficit target was placed at 4.6 per cent, the inflation rate at 9 per cent, the required foreign exchange reserves at 9.4 weeks' imports, the current account deficit at 4 per cent of GDP and GDP growth at 5.5 per cent.

3.3. The third phase (1997-2000)

The three-year Enhanced Structural Adjustment Facility (ESAF) and Extended Fund Facility (EFF) programme agreed by the GOP with IMF/World Bank for the period 1997-98 to 1999-2000 incorporates specific macro-economic targets. These targets include, inter alia: (a) raising the growth rate of real GDP to 5.6 per cent; (b) reducing the inflation rate to about 7 per cent, (c) bringing down the current account deficit (excluding official transfers) to the range of 4.0-4.5 per cent of GDP; (d) raising the gross investment level from about 18 per cent of GDP in 1997-98 to 19.5 per cent in 1999-2000 and (e) increasing the national saving rate from 12.0 per cent of GDP in 1996-97 to nearly 15.0 per cent of GDP by 1999-2000, mostly coming from improvements in budgetary savings. With the gross revenues envisaged to rise to about 17.0 per cent of GDP in 1999-2000 from the level of 15.3 per cent in 1996-97, and current expenditures falling to 17.3 per cent of GDP from the current level of

about 18.0 per cent, the overall budget deficit would be reduced to a level of 4.0 per cent of GDP by the end of the programme period.

The arrangement also emphasised the broadening of the base of the General Sales Tax (GST); the rationalisation of public expenditure through, inter alia, the restructuring of government ministries/divisions, attached departments, and autonomous bodies; public enterprise reform and privatisation; further reforms in the financial sector and reform of the foreign exchange market.

In support of its medium-term economic and financial programme, the Government of Pakistan was to secure a multi-year financial assistance from the Fund under ESAF and EFF amounting to SDR 1.14 billion over a three-year period, 60 per cent at highly concessional rates. IMF's support and Pakistan's structural adjustment programme provided the enabling environment for substantial amounts of external assistance from other official sources over the medium term on concessional terms. At the same time, the Government made efforts to improve the maturity structure of Pakistan's external liabilities (thereby reducing the economy's vulnerability to disruptive capital outflows) and to attract increasing non-debt creating inflows with particular emphasis on containing the growth and lengthening the maturity of foreign currency deposits. The disbursements under the ESAF and purchases under the EFF are subject to observance of performance criteria, completion of programme reviews, and some general requirements regarding the exchange and trade system.

3.3.1. Achievements

Good initial progress has been made with structural reforms in a number of areas, including trade liberalisation (reduction and rationalisation of tariffs), a comprehensive reform of the banking system, tax policy reforms (lowering rates and base-broadening efforts), capital market reforms, and pricing and initial institutional reforms in agriculture. The government is also making renewed efforts to accelerate and broaden the privatisation programme whose pace has slowed down during the past two years, and to drastically improve tax administration whose weakness is the key constraint to raising Pakistan's tax-GDP ratio.

Despite these encouraging developments on a number of fronts, sustaining macro-economic stabilisation efforts and moving ahead further with structural reforms are major challenges in the face of the difficult external environment and serious economic problems at home. The longer-term development agenda

faced by Pakistan is also daunting. A very large proportion of the population is poor, with rising unemployment, particularly in the urban areas, and despite recent progress Pakistan's social indicators remain unacceptably low compared with those of other low-income and South Asian countries.

4. REFORMS IN VARIOUS AREAS

As discussed earlier, no reform effort is sufficient to create dynamism in the economy without an accompanying programme for structural adjustment. An important development in this regard is that, since 1977, there has been consensus among different political parties on the economic reforms including deregulation, liberalisation and privatisation of the economy. Reforms in the trade regime, industrial regulation and the financial sector have been gradual but persistent. Following is a brief discussion of reforms in various areas:

4.1. Deregulation

At the beginning of the last decade, the Government still regulated large-scale industry through investment restrictions and price controls. During the 1980s, the regulation of new projects was liberalised by substantially increasing the size of projects requiring government approval. In 1991 the Government abolished approval requirements for all projects in the private sector except (1) arms and ammunition; (2) security printing, currency and mint; (3) high explosives; and (4) radioactive substances. Government's intervention in control over prices has also been substantially reduced since 1980. Prices of cement, nitrogenous fertiliser and cooking oil have been deregulated.

4.2. Privatisation

Although some small agro-based manufacturing units were privatised in the late 1970s and early 1980s and some shares of public sector enterprises were disinvested, privatisation picked up momentum only after 1990. In January 1991, a Privatisation Commission was established to supervise the privatisation process. By early 1998, 90 industrial units, three commercial banks and two development banks had been privatised. In the infrastructure sector, one thermal power plant was privatised while minority share holdings and the PTCL and PIA were sold in domestic and international capital markets.

One crucial measure which facilitated privatisation was the accord reached with the workers of public sector enterprises to be privatised, according to

which no employee could be dismissed for one year after privatisation. Employees would also be given the option of a “golden handshake” and priority in purchasing shares of the privatised unit.

Lately, the pace of privatisation has slowed down owing to the complexities of disinvesting larger industrial units, financial institutions and public utilities. This requires putting in place appropriate regulatory frameworks and developing a strategy to deal with serious labour surplus problems in large enterprises (which indicates that structural adjustment efforts call for an enabling environment as well as building institutional capacity).

4.3. The financial sector

Throughout the 1970s and for most of the 1980s, the financial sector was heavily controlled and fragmented. Until July 1985, the rates of return that banks could charge on advances were subject to a ceiling of 11% p.a. on investment loans and 14% on working capital loans. Moreover, a large part of advances were to be made on concessional terms. Small farmers were provided interest-free production loans. Under the export finance scheme, loans were advanced to exporters at 3% p.a. The same concessional rate was available for financing the sale of locally manufactured machinery (LMM). Banks were also required to keep 30% of their time and demand liabilities in government securities which carried a return of only 6% p.a. This liquidity requirement was in addition to the 5% reverse requirement. As a result of these policies, the rates of return available to depositors were very low and often negative in real terms. At the same time, the Government paid substantially higher rates on its own borrowings from the non-bank domestic market through the National Saving Schemes (NSS).

Effective from July 1, 1985, banks switched from interest-based modes of financing to 12 modes of non-interest financing. With that came greater flexibility in the rates of return which could be charged on various types of financing.

Concessional rates of return for export financing and for LMM increased. The rate of return on production loans for small farmers has also been increased. With the availability of high-return government instruments to the banks for meeting their liquidity requirement and the increase in concessional rates of return, the profitability of banks improved.

The privatisation of three nationalised commercial banks and the approval for more than 10 new private commercial banks to operate have injected competition into the market. As a result, banks have been actively mobilising deposits by offering attractive terms to depositors.

The government initiated far-reaching reforms in 1997 to address the structural weaknesses of the banking sector. These reforms included replacing nationalised commercial banks' (NCBs) management with professional bank managers from the private sector, amendment in banking laws giving the State Bank of Pakistan greater autonomy in the formulation of monetary policy, enhancing SBPs' authority in banking supervision and regulation, strengthening the loan recovery machinery and substantially reducing the stock of bad loans by NCBs and DFIs.

4.4. Taxation

Pakistan's tax system has been very inelastic and narrowly based. Tax receipts have not been responsive to growth in economic activity because: (1) agriculture, the single largest sector, has been exempt from direct taxation; (2) the system is riddled with widespread exemptions; (3) specific rates of tax are widely used (because of the ease of administration) instead of ad valorem rates; and (4) there is rampant evasion. Because of the inelasticity of the system, new measures were necessary to increase tax revenue. The Government has been aware of the need to reform the tax system and had constituted a National Taxation Reform Commission in the mid-1980s, which came up with a comprehensive report on the subject. However, it was only after 1990 that the Government made a real effort to overhaul the tax system.

A number of income and wealth tax exemptions have been eliminated. A number of fixed, presumptive and withholding taxes have also been levied. As a result of these measures, the contribution of direct taxes to total tax receipts of federal and provincial governments increased from 13.2% in 1989-90 to 23.2% in 1996-97. Receipts from direct taxes increased from 1.8% of GDP to 3.7% of GDP over the same period. In addition to broadening the tax base, the tax rate structure has been rationalised. Under a five-year phased programme started in 1993/94, the corporate income tax rate has been lowered.

The coverage of sales tax has been extended since 1987/88, initially mostly horizontally by bringing a larger proportion of domestic production and imports under the tax net. Subsequently, an attempt has been made to expand coverage vertically from the manufacturer/importer level to wholesale and

retail level for a limited number of items. A programme is being initiated to strengthen the capacity of Pakistan Revenue Service, enhance its skill base, and improve management and incentives for better tax collection and administration.

4.5. The trade regime

In 1980, about 41% of domestic industrial value added was protected by import bans, and another 21% by various other forms of import restrictions. This sheltered inefficiency and exploited consumers through high prices. There was wide dispersion in tariff rates, with a number of items being exempt from duties while others were subject to very high rates. The maximum duty rate was 350% during the 1980s. More than 700 items or groups of items were removed from the negative and restricted import lists starting in the late 1980s. The requirement of obtaining an import license for “freely importable” items not on the negative or restricted lists was abolished in March 1991. The maximum rate of import duty has been gradually reduced to 45%.

Lowering of import tariffs and opening up of the economy will not only promote competition and ensure better allocation of resources and higher growth, but will also ensure lower prices for consumers.

To encourage exports, the duty drawback system has been streamlined. The export of cotton and rice, which had been monopolised by the Government since the 1970s, was permitted to the private sector in 1987. Export duty on cotton has been abolished and trade in the commodity has been totally freed at international prices (allowing free exports and imports). In February 1991, foreign companies were also allowed to engage in export trade.

4.6. Exchange and payment reforms

Since 1982 Pakistan has been following a managed float system for exchange rates. Pakistan's capital account was almost freed in February 1991. Since then both Pakistanis and foreigners, whether resident or non-resident, have been allowed to open foreign currency accounts in domestic or foreign banks, with no questions asked about the source. Money changes have also been authorised in the private sector. As a result, foreign exchange can now be easily purchased in the open market.

Many other regulations which restricted cross-border capital movements were also lifted or relaxed in 1991. For instance, domestic companies' access to foreign credit and foreign companies' access to the domestic credit market

were liberalised. Foreigners and Pakistanis were allowed to make investments on a repatriable basis. Foreigners were also allowed to have 100% equity in enterprises. Elaborate controls, in the form of ceilings on royalties and technical fees which could be paid on the purchase of foreign technology, were also completely removed. Dividends and dis-investment proceeds could be remitted abroad freely. These efforts have suffered a temporary setback in the face of emergent actions.

4.7. Agricultural prices

During the 1980s, the private sector was again allowed to trade in cotton and rice. With advice from the Agricultural Prices Commission (APCOM), the Government began fixing procurement prices by taking into account international price trends, costs of production and net returns to farmers. As a result, the differential between domestic and international prices of agricultural goods decreased in the mid-1980s.

Along with setting agriculture produce prices more realistically, the Government also moved to reduce subsidies on agricultural inputs. Subsidies on pesticides and seeds have been eliminated. Subsidies on fertilisers have been substantially reduced.

4.8. Energy prices

As regards electricity, during the 1980s there was a change in the principle for setting electricity prices from one which ensures a fixed rate of return to the utilities to a pricing structure that allows the utilities to generate sufficient funds from internal sources to finance a percentage of their investment programmes (40% for the Water and Power Development Authority and 25% for the Karachi Electricity Supply Corporation). While the overall level of electricity prices has been satisfactory, the price structure is distorted: large numbers of residential and agricultural consumers pay significantly less than the cost of providing electricity to such consumers, while industrial and commercial sectors pay substantially more than the cost of supply. The latest increase in electricity tariff (21% weighted average increased in early 1998) has reduced distortions in electricity pricing.

In the petroleum sector, producer prices of both natural gas and crude oil have been set with reference to the border prices of imported products (fuel oil and imported crude respectively) since the mid-1980s. This has provided a significant incentive to producers and has resulted in an appreciable increase

in exploration activity during the second half of the 1980s. Consumer prices for gas and petroleum products continue to be set by the Government, and the reliance on the cost-plus approach has essentially been retained for both categories of products. The (average) gas price for consumers is not subsidised, though the structure of prices entails lower prices for residential consumers than for the industrial, commercial and power sectors. In the case of petroleum products, consumer prices are higher than the import price plus marketing costs, thus ensuring that no subsidies are involved. Since kerosene is primarily used for lighting and cooking by low-income consumers (in particular those without access to natural gas), the profit margin is much narrower than in the case of gasoline and diesel.

PART THREE

The impact of the adjustment programme on Pakistan's economy and lessons from Pakistan's experience with structural adjustment are discussed in this part of the paper.

5. IMPACT OF ADJUSTMENT

5.1. Growth

With the reversal of the policies of the 1970s, with more emphasis on the role of the private sector, and with the removal of some of the distortions in relative prices and incentives, Pakistan's overall performance improved significantly during the 1980s. The average annual growth rate of GDP during the 1980s was 6.1% compared to 4.8% in the 1970s. Growth of the economy remained strong in the first two years of the 1990s but sharply declined subsequently because of the poor performance of both the agricultural and industrial sectors. Political crises also dampened business confidence, which adversely affected the pace of the turn-around in economic activity.

5.2. Savings and investment

Investment has been slow to respond to structural adjustment, with total investment during the 1980s remaining at more or less the same level as a share of GDP as in the 1970s. Likewise there has not been any improvement in national savings in the late 1980s and early 1990s, with its ratio to GNP hovering in the 13-14% range in most years. It has, however, registered a significant improvement in 1997-98 increasing from 11.3% in 1996-97 to 15%.

5.3. Inflation

The double-digit inflation which has been recorded for the last five years declined to 8.2% during 1997-98. Although a single year may not be considered a trend yet, the return to a single-digit inflation is mainly attributed to demand management that resulted in disciplined recourse to bank borrowing for budgetary support, tight monetary policy, improved supply situation because of higher-than-targeted growth in agriculture and decline in international prices of major imports.

5.4. Exports

Because of the flexible exchange rate policy, exports showed robust growth from 1984-85 to 1991-92, increasing at a faster rate than imports. However, this failed to reduce the current account deficit because of a more or less continuous decline in workers' remittances since 1982-83. Pakistan's overall export performance crucially depended on the export behaviour of raw cotton, rice and cotton yarn. The production of these primary commodities and semi-manufactures is also related to domestic agriculture support-price policy and production uncertainties associated with weather conditions.

5.5. Fiscal deficit

Notwithstanding the improvement in the overall performance of Pakistan's economy during the 1980s and early 1990s, its internal and external imbalances have persisted. For most of this period, the overall fiscal deficit ranged between 7% and 9% of GDP. Tax collection remained inelastic to GDP growth.

5.6. Poverty

The income-expenditure survey held during the first phase of the Adjustment Programme showed a decline in the incidence of poverty between 1985 and 1988 (pre-programme). Estimates for the programme period are mixed. One assessment shows a decline in the population sector experiencing poverty while other estimates show an increase, at least in the aggregate, between 1988 and 1991. It is pertinent to ask the question whether the increase, if any, in the incidence of poverty is a consequence of the adjustment programme. It is not possible to answer the question readily with the data available. Though structural adjustment may have conceivably led to an increase in the incidence of poverty, it is not possible to isolate this impact due to other factors. One can, however, say that the pressure of inflation must be serious for the poor.

6. LESSONS FROM PAKISTAN'S EXPERIENCE WITH STRUCTURAL ADJUSTMENT

Pakistan achieved mixed success with structural adjustment in the 1980s, but unlike many other developing countries facing similar problems, Pakistan managed to maintain respectable economic growth rates throughout the decade. Internal imbalances were not tackled on a fundamental basis, however (the system was not reformed, nor was the allocation or effectiveness of public expenditure greatly improved), so the performance of the 1980s turned out to

be unsustainable. Political instability aggravated underlying imbalances. Lessons from Pakistan's experience, which broadly fit into global patterns, include the following:

- (1) Pakistan's incremental and flexible approach to structural reforms enhanced the sustainability of these reforms. Throughout the 1980s and early 1990s, successive governments moved ahead with deregulation, liberalisation and privatisation of the economy, building on the work done by previous governments. There has never been a major reversal in the reform process, despite frequent changes of government during the period.
- (2) Winning the confidence of labour in public enterprises was crucial to their successful privatisation. Before embarking on massive privatisation of nationalised enterprises in 1991, the Government offered the affected labour force a very generous package to soften resistance to privatisation. Hence, despite some questions about the transparency of the process, it has proceeded reasonably smoothly during the last three years.
- (3) Inadequate attention to the sequencing of various reform measures can undermine implementation. Introduction of the auctioning of public debt and allowing the rate of interest on government paper to rise in 1991, before reducing the fiscal deficit, accentuated fiscal problems and was partly responsible for the large overall budgetary deficits observed during the following two years.
- (4) Robust growth of exports made it possible to reduce import restrictions and import tariffs. The flexible exchange rate policy since the delinking of the rupee from the US dollar in 1982 improved incentives for exports and increased the supply of major exportables like cotton and cotton yarn, which boosted exports during the 1980s. This was followed by a reduction in import duties and relaxation of non-tariff barriers without further increasing the current account deficit.
- (5) In a country with a highly rigid structure of public expenditure, it is not possible to achieve a sustainable reduction in the fiscal deficit without a fundamental reform of the taxation system. As 60% of the Government's current expenditure is absorbed by defence and interest payments, the scope for reducing expenditures is somewhat limited.

The ad-hoc, discretionary revenue measures imposed by the Government during the 1980s could not reduce the fiscal deficit for more than a year or two at a time. Frequent changes of government also undermined efforts to reduce the fiscal deficit.

CONCLUSION

The extent of fiscal adjustment being attempted by the Government is too large. It has resulted in a variable achievement of targets. First, because it is being achieved through revenue measures some of which are adverse from the point of view of incentive-system and supply-side considerations. Second, the use of some indirect taxes is further feeding inflation. Third, the inflexibility in our programmes with regard to some taxes and deficit target leaves no fiscal space for important and urgent structural measures. And fourth, the cuts in the PSDP have reached the point that, after allowing for “throw forward” of on-going projects, few resources are left for new projects, which is impractical and unsustainable.

The fiscal problem is also aggravated by poor tax collection and absence of proper expenditure control methods. Till recently a vicious cycle had developed, in which poor tax collection prompted successive governments to impose additional tax measures which further stifled economic activity and created incentives for further evasion. In 1997 the tax structure was significantly revised. On the expenditure side, while expenditure overruns continue, cuts are being imposed on the PSDP which cannot be sustained.

There is a need for further implementation of the structural reform programme in order to improve the competitiveness and growth potential of the economy. Redoubled efforts are needed in areas where progress has been limited such as privatisation, governance, and strengthening of tax administration. Priority areas for structural reforms include:

- Maintaining a strong commitment to the Social Action Programme.
- Systematically addressing governance problems.
- Improving technical capacity, removing labour-related impediments to privatisation, and strengthening regulatory frameworks.

Key priorities for stabilisation (which also have significant reform content) include:

- Maintaining and if necessary further tightening fiscal discipline.
- Increasing resource mobilisation.

- Strengthening the financial position of the electricity utilities.
- Continuing to contain the current account deficit and reducing reliance on short-term foreign debt.

Pakistan will continue to require large amounts of external financing during the next several years. A smooth flow of medium- and long-term official assistance, foreign direct investment, and portfolio investment is necessary to reduce external vulnerability, support adequate levels of investment and growth during the transition, and help cover the large up-front fiscal costs of critical reforms (financial restructuring of public sector banks, severance payments to retrenched public sector employees, foreign revenues due to tariff reductions, reform of the power utilities). While much external financing will have to come from private sources, donor support for Pakistan's reform programme and development efforts will continue to be of great importance over the next few years. The level of donor support will depend on Pakistan's progress (in line with the agreed Policy Framework Paper and the IMF-supported ESAF/EFF agreements) in sustaining and pressing ahead with the aggressive achievement of targets for human resource development.