

**PAKISTAN DEVELOPMENT FORUM**  
**ISLAMABAD, APRIL 25-26, 2005**  
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**1. INTRODUCTION**

1. Mr. Prime Minister, thank you for inviting the IMF to participate in the Pakistan Development Forum (PDF). As always, I am delighted to be back home in Pakistan. It is particularly the case this year, when I can report that Pakistan successfully completed its arrangement under the IMF's Poverty Reduction and Growth Facility last December.

2. The graduation from IMF financial support is an impressive achievement. It is rare that a country moves directly from concessional IMF support to market financing. Pakistan's re-entry in the international capital markets, with placements of a Eurobond and a *Sukuk* on very favorable terms, is a strong indicator of the country's impressive economic rebound.

3. The IMF will of course continue to work closely with the Pakistani government, but in the context of our surveillance mandate, as is the case with all member countries. We will continue to conduct an annual review of the economy, and discuss with the authorities economic prospects and policies. As in the past, we will continue to offer advice on macroeconomic policies and provide technical assistance in our areas of expertise.

**II. ECONOMIC ACHIEVEMENTS**

4. Let me briefly draw attention to some of Pakistan's recent economic achievements. I spoke about them a year ago at the PDF, but it is worth reiterating the key points.

5. Pakistan has convincingly recovered from the crisis of the late 1990s. Most importantly, sound macroeconomic policies and a wide range of structural reforms have resulted in a revival of economic growth, to 6½ percent in 2003/04. And growth continues to accelerate. It is expected to reach 7-7½ percent this year, with good harvests and continued very strong growth in manufacturing.

6. Strong growth has been accompanied by a strengthening of government and central bank balance sheets. Fiscal discipline, accompanied by external support has led to a substantial improvement in public and external debt indicators. Reflecting strong export growth and remittances, the balance of payments has strengthened and the State Bank of Pakistan's (SBP) international reserves now are above \$10 billion, covering almost half a year of imports of goods and services.

7. Within fiscal consolidation, room has been created for increased social spending. Consolidation was achieved largely by savings on the interest bill and higher revenues. The resulting fiscal space was used to reduce government debt and raise social and poverty related spending, as envisaged in Pakistan's Poverty Reduction Strategy Paper (PRSP).

8. Not surprisingly, in view of the strong economic growth inflationary pressures have built up in the last year-and-a-half. Initially, ample slack in the economy, combined with a strong demand for money, pennitted the SBP to lower interest rates, and thus to support economic growth, while inflation remained in the low single digits. But inflation started to pick up in 2003 and 12-month consumer price inflation has been at a level of about 9 percent since mid-2004. Even though there has been a significant tightening of monetary policy, most interest rates remain negative in real tenns.

9. The easy monetary policy also contributed in part to a very substantial rise in real estate and stock prices. The stock market rally witnessed over the past few years was recently partially, and quite sharply, reversed, however. Shortcomings in the regulatory framework and supervision, especially of the futures market, combined with tensions arising from the transition to new margin financing rules, are said to have contributed to these events.

10. The economic recovery, and particularly the strong performance in agriculture, is likely to have resulted in a reduction in poverty. A small survey conducted last year suggested that this was indeed the case. Unfortunately, comparable data that would allow a firm assessment will become available only later this year once two large household surveys have been completed. We await evidence that Pakistan's strong economic performance has helped to reduce poverty.

### III. THE CHALLENGES AHEAD

11. While Pakistan has made good progress in the past few years tremendous challenges remain. The government is the first to recognize this. One of Pakistan's Millennium Development Goals is to reduce the share of the population living below the poverty line to 13 percent by 2015. To help achieve this, the government aims to further accelerate the pace of economic growth, to 8 percent per year, as also outlined in the draft Medium Term Development Framework (MTDF). We believe this is ambitious, but feasible.

12. Several elements will need to fall into place to enable a further increase in the pace of economic growth. The external environment-as well as weather and security conditions-will need to remain favorable. On the policy front, sound economic policies need to be continued, aimed at safeguarding financial stability. Also, the "second generation" structural reform agenda, as the government has put it, will need to be advanced further, to strengthen the business environment. These elements together would enable the increase in both private and public investment that is envisaged in the draft MTDF and that would be needed to achieve sustainable rapid. growth.

13. Regarding the external environment, industrialized countries can help by further reducing trade barriers. Pakistan was one of a few countries, apart from China, expected to benefit from the removal of the textile quota system at the beginning of 2005. The first indications are that textile exports have indeed increased, but that there may have been some downward pressures on prices. Besides increased competition, which was to be expected, downward pressures could also reflect the higher import duties that Pakistan textiles face in some markets, particularly in the European Union where Pakistan lost its Generalized System of Preferences status. At this conference, where we discuss how the international community can help Pakistan achieve its development goals, the need to further reduce trade barriers in industrialized countries has to be stated clearly.

14. The creation of the South Asian Free Trade Area (SAFTA) offers an opportunity to increase trade and income in the region. The IMF fully supports efforts to pursue regional integration under the SAFTA framework, and we are ready to assist governments with analytical work, if needed. The potential for trade creation and increasing welfare is large, in light of the current very low level of regional trade.

15. Turning to domestic policies, a further tightening of monetary policy remains needed to reduce inflation. Rapid import and credit growth and rising core inflation indicate that the economy continues to heat up. There is a growing risk that expectations of higher inflation become entrenched. And once they do, it will require a much harsher tightening of monetary policy to bring inflation down again. Higher price and wage pressure, combined with limited exchange rate flexibility, as witnessed since the beginning of the year, could eventually hurt Pakistan's competitiveness. So far, this has not been a problem, as Pakistan's real effective exchange rate depreciated by almost 10 percent over the past four years.

16. Fiscal policy, meanwhile, will need to continue to balance the need for further reducing the debt burden and increasing social spending. Sound policies have put Pakistan on its best financial footing in years, but the public and external debt burdens are still relatively high. The recent adoption of the Fiscal Responsibility Law shows the government's commitment not to let up on fiscal policy. With strong growth, the budget deficit would need to be limited to about 3 percent of GDP in the coming years to reduce the public debt-to-GDP ratio to about 50 percent by 2008/09.

17. Key to realizing the fiscal goals is raising the share of tax revenues in GDP. The tax-to-GDP ratio in Pakistan is relatively low at 11 percent. We encourage the government to set more ambitious revenue goals than envisaged in the draft MTFD and the PRSP. To achieve this, efforts should focus more at expanding the tax net further into the agricultural and services sectors, rather than reducing too much tax rates for the manufacturing sector in the hope of boosting growth in this sector, and thus future revenues. In the past few years, tax revenues have not shown the buoyancy that would warrant such an approach. Petroleum levies should be returned to their earlier levels, as subsidizing petroleum prices—even if the budget is able to accommodate it—is economically inefficient and socially ill-targeted.

18. Similarly important it is to reduce the drain on the budget posed by transfers to various state-owned entities. The most prominent ones are in the power sector, with transfers amounting to about 1.2 percent of GDP. Major steps have been taken with the unbundling of the Water and Power Development Authority and the sale of the Karachi Electric Supply Corporation that is currently underway. But a new regime for electricity tariffs and subsidies has yet to come into effect.

19. Last, but certainly not least, Pakistan needs to complete its "second generation" structural reform agenda, to create an environment in which private initiatives can flourish. Already, a World Bank analysis found that it is easier to enforce contracts or to start up a new business in Pakistan than elsewhere in the region, but more is to be done. The privatization process is set to continue. Financial sector reforms, combined with lower government borrowing needs, have resulted in a healthier and more competitive banking system that is eager to expand into private sector lending. Supervision and regulation *of* the stock market, however, needs to be strengthened further, to reduce the possibility of the type of bubble and subsequent correction that occurred recently.

#### **IV. CONCLUSION**

20. In conclusion, Pakistan is rapidly developing into a healthy and vibrant economy. The country seems well on its way to reach a higher growth path. *Of* course, risks always remain. But the achievements *of* the past several years have left Pakistan much better placed to deal with adverse shocks. This leaves me to wish the authorities continued success in their endeavors and to assure them of the IMF's continued and full support.