



Keynote Address for Minister of State for Finance for Session-VII, Pakistan Development Forum May 2006

Second Generation Reforms

Madam Chairperson, Honourable Delegates, Ladies and Gentlemen:

I have been given an opportunity to speak on a very important topic, that is, the second generation reform. More importantly, I have been asked to speak on the current and future agenda of reforms. Let me state at the very outset that structural reform is the essence of development. Broadly speaking, structural reforms entail measures that change the institutional framework and constraints governing market behaviour and outcomes. In general, structural reforms have been associated with the notion of increasing the role of market forces and reducing the extent to which government regulations or ownership of productive capacity affect the decision making of private firms and households. It would, however, be misleading to equate structural reforms with the goal of abandoning regulation altogether. Our view is that structural reforms aim at adapting institutional frameworks and regulations for markets to work properly. But we all know that some markets are prone to market failure or inefficiencies, therefore, there is a role of the government to correct the market failure and improve the efficiencies of the markets. Structural reforms, therefore, do not abdicate the government to play its due role.

Ladies and Gentlemen:

Pakistan has lived through difficult and testing times in the not too distant past. As is well-known by now, our economy was fragile, the balance of payments were highly vulnerable to external shocks, the country's debt burden had reached unsustainable level, foreign exchange reserves were not even sufficient to finance few weeks of imports, financial indiscipline was the order of the day, and international rating agencies had downgraded our rating to Selective Default. The analysis of the state of the economy at that time suggested that Pakistan required a prolonged period of macroeconomic stability,

financial discipline, and consistent and transparent policies. While on the one hand we implemented policies that would improve the country's macroeconomic environment, on the other, we implemented wide-ranging structural reforms in almost every sector of the economy to improve the supply-side response by removing impediments to private sector development, removing irritants to improve investment climate and improving the allocation of resources.

To refresh your memory I would like to record some of the major reforms that we have implemented so far. These include: financial sector reforms, capital markets reforms, tax and tariff reforms, reforms in tax administration, fiscal transparency, reforms in privatization program, governance reform, particularly with respect to devolution and capacity building, agricultural reform, particularly with respect to agriculture pricing, movement of commodities and introducing private sector in wheat operation, and most importantly, the passing of the Fiscal Responsibility and Debt Limitation Act 2005 passed unanimously by both houses of Parliament. The last one was very essential to pursue a rule-based fiscal policy to inject financial discipline.

But, where are we now? Notwithstanding a series of domestic and external shocks Pakistan's economy has made significant progress over the last six or seven years. The complexion of Pakistan's economy has changed altogether. Most importantly, the economy is no longer fragile. Indeed, it is more healthier today than ever before. It has absorbed the shocks of unprecedented rise in oil prices and the devastation caused by the earthquake of October 8, 2005 and continues to grow strongly. The success of the policies and the reform programs can be judged by the facts that we have witnessed strong economic recovery; succeeded in reducing poverty and unemployment; we have succeeded in narrowing the revenue-expenditure gap; the country has witnessed sharp reduction in its debt burden; exports, imports and tax collection are growing at a high double-digit rate; workers' remittances continue to flow at over \$ 4 billion per annum; exchange rate remains stable; inflow of foreign investment continues to rise; the privatization program is gaining further momentum; foreign exchange reserves continue to rise; credit rating has been improved; Pakistan has re-entered the international capital market and succeeded in extending a whole range of yield curve from 5 to 30 years in the shortest possible time (*two years*); and now

Pakistan is also entering the international equity market by listing OGDCL, most probably in London or Luxemburg Stock Exchange through the GDR. These achievements in such a short period of six or seven years are not mean achievements. There are regions striving to improve the lives of their people with assistance from the international community but have not succeeded in several decades. What made the difference in our case? I believe, it is the commitment of the leadership to introduce home grown reforms executed by Pakistanis themselves, despite strong opposition from the few status quo bias elements.

The economic landscape of Pakistan has changed, therefore, our challenges have also changed. Six years ago our challenge was as to how to revive economic growth. The challenge today is as to how to sustain the growth momentum. We believe that we have laid the foundation of a stable and strong economy and the stage is now set for the economy to grow in the range of 6 – 8 percent per annum in the next 5 years. However, we also believe that the growth of this magnitude will not be forthcoming automatically. To sustain a growth momentum of 6 – 8 percent per annum would require more efforts and more reforms. Reform is a dynamic concept. The economy must continue to adjust with the changing domestic and international environment. The only constant is change. The growth momentum would lose steam if we do not introduce further reforms or what we call second generation reforms.

Ladies and Gentlemen:

Over the next five years our reform agenda includes strengthening institutions, improving the competitiveness of our industry, building a robust financial system in an environment of global financial restructuring, further strengthening of tax administration, promoting transparency in economic policy-making, further reform in capital markets and strengthening the country's physical and human infrastructure. While it is not possible to discuss each element of reform I would, nevertheless, attempt to provide some flavour of these reforms.

Strengthening of institutions is vital to remove obstacles to higher growth and better social service delivery. As part of institutional strengthening the government has already launched major initiatives, prominent among those are reforms in judiciary, police,

civil service, and pension, the restructuring of the Central Directorate of National Savings (CDNS), transforming the existing Monopoly Control Authority (MCA) into a Competition Authority Organization, and introduction and adoption of E-Government Strategy. Furthermore, the government has already setup a Commission to assess existing regulations and procedures affecting the interaction between the administration and the business with a view to eliminating red tape and with it, corruption opportunities. It is clear that **judicial reform** is aimed at strengthening the rule of law and enhancing the transparency and accessibility of the legal system by modernizing the court system at all levels and strengthening capacity, effectiveness, and accountability of law enforcement agents. This is an on-going and difficult reform and as such the progress is relatively slow. We are making efforts to enhance its speed. Some progress in **police reform** has also been made. The **civil service reform** is also an on-going reform and major progress has been made in enhancing the capacity of our civil servants through training within and outside the country. On **pension reform**, we are at a fairly advance stage of introducing contributory Provident/ Pension Fund Scheme for the new entrants. The work on converting the **existing CDNS into a corporate body** is also at a fairly advanced stage. The government believes in a free-market system but in recent years we have witnessed the rise of extra-market forces leading to market failures and creating hardship for ordinary consumers. It is in this perspective that the government is revamping the **existing Monopoly Control Authority by converting it into a Competition Authority with proper powers to deal with extra-market forces.** This work is also at fairly advanced stage. In order to improve the efficiency of various ministries the government is working towards **achieving ISO 9001 Certification**. A beginning has already been made with Ministry of Finance working towards achieving this certification. Four wings of the Ministry of Finance will be ISO 9001 certified by August 2006, and the complete ministry will by ISO 9001 certified by March 2007. The **restructuring of the Federal Bureau of Statistics** with a view to converting it into an **autonomous institution** is also high on the agenda of reforms. I would also like to inform you that given the importance we attach to the implementation of the second generation reform the government is setting up an Economic Reform unit in the Ministry of Finance with a view to coordinating with other ministries in implementing various reforms. This unit will also serve as Secretariat for the Private Sector Development.

Improving competitiveness of Pakistan's industries is central to our reform agenda. It deals with improving the investment climate by strengthening microeconomic sources of competitiveness. Improving competitiveness requires understanding of various impediments and policy bottlenecks that affects competitiveness of our industry. Most important element of improving competitiveness is the strengthening of the country's physical infrastructure, that is, the supply of gas, power, working of ports, roads, rail linkages, telecommunication network, and water availability. Given the resource constraints on the one hand and the role strong infrastructure in enhancing competitiveness on the other, the government has recently setup Infrastructure Project Development Facility in line with public-private partnership. The Competitiveness Support Fund has been established under the Ministry of Finance as an independent body with the collaboration of USAID and has a grant of \$22 million with the Ministry of Finance and the USAID providing a 50% share each. The goal of the CSF is to provide venture capital funding, Matchmaking facilities, and helping to foster cooperation between government, educational institutions and the private sector. To bring competitiveness into the forefront of decision making, the Ministry of Finance and the USAID are hosting the Asia-Pacific Regional Conference on Competitiveness organized by TCI from May14-16, 2006 in Islamabad. Furthermore, to improve the competitiveness of our industries the Government has commissioned a number of studies with the help of development partners to examine microeconomic constraints in improving investment climate and promoting private sector development. Other major irritants that are receiving our serious attention include: the frequency and trend of various line department officials visiting factory premises? Has the clearance time from custom been reduced significantly? Has the waiting period to get power, telephone and gas connection been reduced effectively? Is the SME sector getting adequate credit at market rate? Is the private sector receiving quick refund of sales tax because of the STARR project? These are valid questions and various initiatives have been launched with assistance from our development partners.

The **banking and financial sector** of Pakistan is much stronger today than it was some one decade ago or in comparison to other countries in the Asian region. However, we have to further strengthen our banking system to meet the challenges arising from global financial restructuring. Our future reforms include: voluntary mergers and consolidation of smaller banks to become effective and strong banks; further strengthening of the legal

infrastructure of the banking system; formulation of new Banking Law to deal with current and future challenges; a deposit insurance scheme to protect the small depositors; further liberalization of financial services in the context of TRIMs; promoting transparency and accountability in the banking system; and observance of international standards.

Tax administration reform is the cornerstone of our reform agenda. A major overhaul of the Central Board of Revenue (CBR) is being implemented. It aims at increasing the CBR's effectiveness, reduce corruption opportunities, and raise the buoyancy of the tax system through organizational restructuring, self assessment, elimination of personal contacts between tax-payers and tax authorities, simplified processes, tax-payers facilitation, revised terms and conditions for employment of the CBR officials and improved IT management. We have made considerable progress in these areas but much more is required to make the CBR an efficient tax administration for which many initiatives have been launched and are at various stages of implementation.

Transparency in economic policy-making is vital to build investors' confidence. In this respect, maintaining consistency, transparency and predictability of economic policies will be essential. Maintaining consistency and transparency in government policies has been the hallmark of this government and this policy would continue going forward. The government has introduced wide-ranging reforms in capital markets. As a result, Pakistan's stock markets have emerged as one of the fastest growing markets in emerging markets of the world. Further reform includes demutualization of stock exchanges, which is at an advanced stage.

Ladies and Gentlemen:

I may not have done justice in explaining these reforms as time would not permit me. What I would like to emphasize is that the government is committed to introduce reforms which I have just stated. Pakistan has immensely benefited from the first generation of reforms and there is no doubt in our mind that the introduction of second generation of reforms would further strengthened the economy of Pakistan.

Thank you.

