

Pakistan Ascendant
Address to the Pakistan Society, London
By
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I am delighted to be invited to address this group. We have just heard from my friend and colleague of more than twenty years, Dr. Ishrat Husain. I will not repeat the detailed story Ishrat has just told. Suffice it to say there has been a tidal change in the past five years from the situation his government inherited. GDP has grown from c. 2% to over 8% per annum. Foreign exchange reserves grew from almost an empty vault to more than four months of imports. Domestic borrowing interest rates have fallen from 16% or more to less than 10%. Public debt has fallen from around 100% of GDP to about 60%, and is still falling. Policy continuity, reduced trade protection, improvements in the business environment and low interest rates have resulted in an increase in both domestic and foreign investment. Improved fiscal performance and growing fiscal space resulted from savings on interest expenditures, which fell from c. 6% of GDP to just over 3% now. This plus generous external support and improved revenue administration have enabled the government to exceed the targets for social spending. Social and poverty related expenditures have been raised from 3.8% of GDP in 2001/02 to 4.7% of GDP in 2003/04.¹ In short, Pakistan has successfully laid the groundwork for sustained growth and significant poverty reduction.

Improving investors' confidence was one of the major goals of this Government that has been met with great success. You probably all know the progressive rise in Pakistan's external credit ratings and the very competitive rates Pakistan's dollar bond offerings have received. More important have been the rises in capacity utilization in textiles, cement, steel, fertilizer and other basic manufacturing. These have led to much private domestic investment in capacity expansion. You can see this investment best in the rapid rise in imports of investment and intermediate goods that is pushing the import growth rate to 35% or more.

There has been a sweeping privatization drive that is still gaining momentum. It is leaving in its wake a growing number of very profitable industries. The commercial banks are growing both their business and their profits with astounding results. Many of the commercial banks have reported growth in profits close to 100%; and the best is still to come, with borrowing rates rising faster than deposit rates. The deregulation of the telecom sector and sale of PTCL has produced an explosion of players—mobile phones, cable television, radio stations, internet service providers and many others. There has been a tidal change in the regulation of the oil and gas sector and more is to come with the sales of managing interests of many large public oil and gas entities-- PPL, OGDC, SNGPL, SSGPL and others--all along the chain from exploration and development to production to transmission to retail distribution. The share prices of all these companies are booming despite the March crash due to the very rapid rise in their reported profits with a very rosy outlook for the future.

Basic public utilities are much tougher to unbundle and manage in a business-like way (or better, sell); but the progress in even these areas is encouraging. WAPDA's power monopoly is being busted up, with the sale of the Karachi Electric Supply Company (I'm keeping my fingers crossed) and the unbundling of the stone-age mammoth into three GENCOS, one National Power Generation Company and 8-9 DISCOS. The managing interests of some parts of these will be put on the market for sale very soon. PIA's passenger monopoly is gone, with the result of improving service and falling fares. The railways have a new outlook with a looming separation of ministry and management roles, a business focus on freight, and talk of private haulage of freight. Even Pakistan Steel will be offered for sale.

¹ The PRSP defines the following budget categories as PRSP expenditures: Education, Health, Rural Development, Irrigation, Social Security and Food programs, Population, Disaster relief, Roads Highways and Bridges and Land Reclamation, law and order, justice, low cost housing, village electrification, and Tawana Pakistan.

The big business opportunities in Pakistan will come in the next 10 years. Sustaining GDP growth of above 6% per annum and reducing poverty from 35% to 15% in the next 10 years will bring about a social transformation that will throw Pakistan into a fit of modernization. Of course there is nothing inevitable about this and the “Pakistani Pessimists” could prevail. These hopes could be dashed in a variety of ways I discuss as risks at the end of this paper. Nevertheless, progress in the last five years puts optimism in the ascendant which allows me to imagine the hopeful scenario below.

There will be progressive and fundamental structural change with rising foreign trade, employment in manufacturing and modern services, urbanization and consumerism of the growing middle class. I cannot predict which particular goods and services will prosper in these coming ten years; but it is easy to see the work that needs to be done in overhauling the basic economic and social infrastructure, where the big profits will first be made.

Pakistan has the largest interconnected irrigation system in the world. It has been neglected in the past several decades with the result that the entire system needs management reform, modernization and some major investments in large dams on the Indus. Water is scarce and precious and the very well defined water allocation entitlements need meticulous enforcement. The present institutional arrangements have proven incapable for the task. The management of the system needs a client responsive culture with the irrigators in control of the lower reaches of the distribution system. Where local farmer organizations have taken over the distributaries, the water shares are honored, water reaches the tail-enders and the abiana (water rates) are collected. For this to work throughout the irrigation command areas, the physical system from the head works to smallest outlet has to be rehabilitated to allow it to meet its design discharge. Only then will it be physically possible to deliver the water entitlements throughout the system. Most of the water that enters the Indus Basin is allocated to irrigation, urban and industrial use and environmentally necessary discharge to the sea. Nevertheless, there is good case for at least two major water reservoirs on the Indus for a total of ten MAF or more to shift water availability from the summer’s spate to winter’s drought. Of course, getting the nationwide consensus to build these reservoirs will require confidence that the water entitlements of all will be respected. And getting the entitlements enforced will require transparency of exactly what these entitlements are and the precise measurement of how they are being fulfilled, so every stakeholder can monitor his own stake in the system.

The demand for power rises faster than GDP in Pakistan and maintaining fast growth requires reliable electric service. Even when generating capacity is adequate in terms of total megawatts, as is the case at the moment, business needs reliable power which in turn needs a reliable transmission and distribution system. Pakistan needs an urgent rehabilitation of its neglected transmission and distribution system, which has become shabby and overloaded; and it needs to start now (even better, yesterday) to build the generating capacity to meet the future demands. The power system has been running with large financial losses (more than 1% of GDP despite big service gaps and low investment), leaving no capacity to fund the needed O&M, modernization and expansion that is crucial to allow Pakistan to grow. Busting up WAPDA will not in itself create surpluses out of these large losses. Of course there are huge efficiency gains to be had in reducing unaccounted for losses, eliminating collusion between employees and customers and managing in a businesslike way. There are also huge opportunities in developing new generating capacity, most importantly using domestic energy sources—hydro, natural gas and possibly coal, wind and sun. There are many good hydroelectric sites for generating cheap electricity. There is more gas declared commercial than being taken, more proved than declared commercial, more discovered than proven, more prospective than discovered, and more indicated than being explored. There are large coal deposits, though those in Thar seem to be very high cost sources of electric power. The financing and management requirements of these power developments are huge and beyond public sector capacity. Government is searching for a package of incentives and assurances that will begin the flow of private capital and expertise into these enterprises.

The coming decade will see a complete overhaul of the social infrastructure—education, health, urban, public administrative and security services. The delivery of these services is caught in a dysfunctional triangle of the service provider (teacher, public health worker, water supply agency, government official, policeman, judge, bailiff) not being responsive to the service client, when the client does not pay directly for the service provided.

When the client does pay directly, for schooling or tutoring, a private health clinic, for his own water pumping, to the patwari for needed documents, to the police for protection, then the service is provided. The public policy makers and administrators that provide the policies and public funding for these public services are too distant, have too few funds and are motivated by too many non-public incentives to closely supervise the public providers. I do not have the detailed answers to how exactly the overhaul will come about; but I can see the outlines of the solutions in moving the public policy managers (government) closer to the clients through devolution to local governments, more use of public funding for private provision (community schools, education foundations) , private management of public functions such as health facilities, water supply, sanitation, solid waste and land recordation systems; and the concerted mobilization of community organizations to take charge of their lives, interact with local government and provide their own services. Getting the incentives aligned between the policy manager, service provider and the client will make the present social infrastructure deliver better; but the infrastructure itself needs rehabilitation and modernization and expansion.

The Government of Punjab is getting good results in terms of dramatic rises in school enrollment by a comprehensive program of rehabilitation of schooling and providing better incentives. All Punjab Government schools will have had missing facilities supplied, along with massive teacher training by next year. The Government of Punjab has introduced demand side incentives of free tuition, free books though class ten for all students throughout the province and Rs 200 per month stipends to middle and secondary school girl students in low literacy districts. Perhaps most revolutionary of all, the Punjab Education Foundation has been restructured to provide schooling grants for low cost private (including non-government) schooling.

The federal Government of Pakistan has embarked on a major reform of higher education that will result in an explosion of better trained university graduates and post-graduates in the next ten years. The Higher Education Commission has taken over the functions of the moribund University Grants Commission with great energy and rapidly rising funding. It is improving the governance of existing universities, facilitating the re-entry and further training of Pakistani academics and using merit criteria for the funding of a much larger research program.

Urban development has reentered the priority agenda of all levels of government. The introduction of local government has opened up debate on how best to govern cities large and small; and how to make them work to unleash their crucial economic potential. One important feature of the improvement of urban service delivery will be the extensive use of private sector management of delivery of public services such as water, sanitation and solid waste disposal.

The growing middle income families will express their consumption demand for modern living with major impact in the next ten years. Pakistan has already seen the doubling and doubling again of sales of motorcycles, cars, fridges, air conditioners, TVs and other consumer durables in the last five years. This has been accompanied by the growth of modern commercial banks' provision of consumer loans. The real estate boom has some elements of asset speculation; but underlying this is a long-suppressed housing hunger that will sustain a housing construction boom for decades. This will feed back into the rising demand for urban services and energy of all kinds, and urban and rural connections to power and natural gas. Along with this the demand will rise for banking, financial assets, life insurance, credit, travel, culture, TV, radio, cable, Internet, advertisement.

There are risks, as there are in all periods of great transformation. Perhaps the biggest risk is that of leaving behind too many families from the general growth in employment, income and prosperity. This can be mitigated by concerted efforts, underway, to invest in the rural and backward areas with basic social and physical infrastructure. As one revolutionary example, the GOP has quite credible plans to bring electricity to every village in a matter of two years. There are many other widespread initiatives in water supply, roads and micro-credit. Perhaps the most important idea is the massive mobilization of village organizations to take control of their own developments and build the capacity to interact with local governments to get the basic public services supplied in sustainable and well-managed ways.

The grim alternative to giving all a major stake in the growing prosperity is an unending clash of the many conflicting groups in Pakistan. I need only mention Baluchis, Pushtuns, Sindis, Punjabis, Muhajars, Shias, Sunnis, religious extremists to conjure up visions of disharmony. It is the fair sharing of the fruits of a rapidly growing harvest that brings about the harmony and consensus required to keep the boom booming. These same contending groups and other social divides make political harmony also difficult to maintain. The return to a fully functioning elected parliamentary system over the next ten will require principled search for fairness and respect in dealings with others. A healthy political harmony and consensus on economic matters will be necessary to maintain the crucial macroeconomic and financial balances in the budget deficit, interest rates, exchange rates, debt and reserves, trade gaps and inflation. The biggest macroeconomic risks are that the domestic and foreign saving and investment needed to sustain rapid growth will not come fast enough. Pakistan's present level of national savings and investment both below 20% of GDP cannot sustain for long growth rates above 6% per annum. For comparison, India's are 30% and China's are 40% of GDP. Foreign saving in the form of private foreign investment, loans and bond subscriptions, possibly donor aid should also rise to sustain investment. Growth, suppressed for a decade or more by bad and erratic policies, when released from these policies, can spurt for a few years; but sustain it, savers and investors much have long-term confidence in the supportive management of the economy to take the risks needed to increase their stake in the future.

Shocks from outside can destabilize in ways that could slow down the progress possible. Maybe the greatest risk is return to open warfare in Afghanistan. Relations with India are warming rather than cooling and prospects are better than any time in my forty year experience in South Asia of a real accommodation of interests leading to a lasting peace and openness between Pakistan and India. Climate change is having its effect; it appears, in the prolonged drought of the recent past, unprecedented recent floods, earthquakes and other adverse natural events. Global warming will probably enhance the flows from ice melt into the Indus Basin over the next decades; but this will eventually lead to reduced flows, by which time Pakistan must have learned to get much more income from every drop of water by better management from the mountain tops to the root zones of the crops. Finally there are the contagious diseases that can have catastrophic effects. AIDs, Avian flu, Hepatitis C are potential big threats to add to the persistent mass public health epidemics of TB, malaria and diarrhea. One hopes some of these will go the way of Smallpox and soon, polio, into the dustbin of history. Childhood vaccinations for most contagious diseases, DOTs treatment for TB, hyperactive surveillance and quick harm reduction for AIDS and Hepatitis C, Avian flu and other potentially harmful diseases can mitigate these risks.

So there are plenty of risks for the pessimists to worry about. But today the optimists have the upper hand and are moving forward to a bright future for all Pakistanis.