

Dramatic changes, high expectations: Can the government deliver?

Daily Star (DS): Please give us a brief overview of the economic reforms you have instituted in Pakistan.

Sartaj Aziz (SA): There are two main pillars of the reforms, namely privatisation and deregulation. Those who would recall the history of Pakistan, say in the 60s when Bangladesh was a part of Pakistan, we started a major liberalisation programme when it was not very fashionable to do so. If you take West Pakistan which is now Pakistan, the average growth rate of the economy in the 1960s was almost seven per cent. Unfortunately, towards the end of this decade a debate started about the income distribution effect of the whole thing — there was a major controversy surrounding the 22 families, who it was said, owned two thirds of the wealth of Pakistan. It was said that 80% of all subsidies, and 90% of all bank loans had gone to the 22 families.

This debate greatly maligned Ayub Khan's record. This affected the elections of 1970 and Bhutto won the election on that platform. So as a reaction, he came and changed course — he nationalised banks, industries, insurance companies and the trend toward liberal economy got subverted. I do not imply that public sector or socialist system cannot work in any way — but it has certain prerequisites. One — a strong ideological frame-work and a strong disciplined party cadre. In the absence of these two elements you end up with bureaucratic socialism — which gives you the worst of both the worlds. In a public sector industry the problem arises because they become over-staffed. Government is always under pressure to give jobs to people. In all the units that Bhutto nationalised, within two-three years, their staff doubled, tripled. So from the very beginning the units become overloaded.

Then the price policy was not market-oriented. Public sector is supposed to supply cheap vegetable ghee, cheap cement, etc — so you can't adjust prices. So subsidies begin to come in. Innovations that come with private enterprise, the modernisation, investment, risk taking all suffer. Why should a civil servant take risk and innovate?

There was also overregulation of the economy. For everything there was a lot of permission required from the federal and the provincial government, local authorities. And this happened for not just one year, two years but for the last 20 years. This drained our resources.

DS: Would you say that till the late 60s you had a liberal economy and...

SA: We had a mixed economy moving towards liberalisation. From '71-'72 onwards we began to become an over-regulated economy. We nationalised industries, particularly banks and insurance companies, and therefore we were unable to grow up to our potential. This continued till about the last two years.

DS: What was the growth rate of West Pakistan in the late 1960s?

SA: The annual GDP growth rate was 7%. The industry grew at 14% for the first five years, 10 to 11% for the second five years. So the average is 12 to 13% and agriculture was about 3.5%. But the economy slowed down during the 70s. Agricultural growth remained at 3.5 to 4 per cent. But industrial growth came down to 5 to 6 per cent. This average growth rate was sustained not by structural changes, science based industries, or value added industries.

For the last 30 years average growth rate has been 6 to 7 per cent. This growth rate has been mainly sustained by growth in agriculture and water sector, and by continuous budget deficit. This budget deficit was sustained by public borrowing, which had to be stopped. Because of the budget gap we could not sustain the infrastructure — because of that we could not sustain the social sector. So we lagged behind in education, health, family planning etc.

Reforms

There are the five major areas where we introduced reforms.

First was to reduce the role of the government. Through privatisation we reduced the role of government in all sectors where government is not good at doing things, and shifted resources to sectors where government is. Which is infrastructure building and social services. I call it the first basic structure.

Second we deregulated the economy to create an environment for growth. People, the private sector should get on with their jobs, create wealth; and things like that. The government should, meanwhile, concentrate on what it is supposed to concentrate on — social sector, education, health, drinking water — all these less developed areas that affect the poor people. That is what the government should be doing with its resources.

Third element of reforms was our thrust was on privatisation. I must say our privatisation policy has gone off fairly well. We went through some phases of experimentation. We had about 110 units to sell. Some of them were nationalised units, some we had set up ourselves. To sell these units we had initially advertised one by one and we did not get a good response. Then we started to announce the premium price — evaluation price — and some people found it too high. So in September last we decided not to fix any price and we announced that all the 100 units would be sold at one go. We received about 272 bids. Out of which about 25 were up to our evaluation price. So those we sold off right away. Then the rest we sold with a reduction of 10% from our evaluation price. We said if you can match 90% of the price you can buy it. By end of June, we had sold 54 out of 100 units for about 10 billion rupees. The remaining ones we have re-advertised. Now we have gone down to 80% of our original evaluation price.

Privatisation Commission

DS—We have heard about the Privatisation Commission. What is its role?

SA: We have set up a Privatisation Commission to handle this task. It is a semi-autonomous, independent Commission. It is chaired by a senator, and is composed of members of parliament, private sector people, chartered accountants and some officials. They advertise and they take decisions. There is a government committee chaired by myself, the finance minister, and 4-5 other ministers. We meet every two weeks and we give them decisions. So it is not a bureaucratic process. No file submission, no proposal. It is a business like operation

and that is why they are able to do things very quickly. They just open the bid and take decisions on it. Where policy decisions are required they come to us. I hope in the next 3 months at the 80% level we will be able to sell another 20-30. We may be left with 15-20 which are closed units. We'll probably sell them as real estate, if we can't sell it otherwise. The units we have sold are all doing well and being expanded.

Tackling the Labour Issue

DS—How did you tackle the labour issue while selling out nationalised units? Did the Labour unions co-operate?

SA: The labour was obviously not very happy with the privatisation because they thought they would lose their jobs. So we offered them two packages. One was the 'golden hand-shake', the other was continuing on the job with the prospect of retraining and redeployment. At first they came with a very elaborate demand; one plus 6. One month salary for each year of service plus 6 months salary. But ultimately we negotiated at 1 plus 4. That we will give them.

The law is that every one is, on separation, entitled to one month salary for each year of service. So now it is one month plus 4 months. So it comes to 5 months salary for each year of service. Somebody who has worked for 20 years can now get 100 months salary if he accepts the "golden hand-shake". The funding for the "golden handshake" comes from the new owners in case of units that were making money. In other cases it is shared 50-50 between the new owner and the government. In some cases we pay the whole amount from the privatisation fund. Our policy is not to spend more than 20 to 25 per cent of the proceeds we have received from the unit, on the golden handshake.

So far our efforts to cooperate with the labour unions have worked. We have also given preference to the labour to buy our units. So 5 out of the 54 units have been sold to the workers.

New Sectors

DS—The reserved areas, are you opening them up also to the private entrepreneurs?

SA: Our second step to promote the privatisation process is to open up all sectors to the private enterprise. This includes ports, shipping, airline, telecommunication, power generation, railways.

We have already given some sections of the railways to the private sector. We have given out jetties to the private sector to build and operate. We have also allowed private telephone companies — some have already come in the cellular telephone and mobile ones. We are also discussing about privatisation of tele-communications. We are also privatising the power sectors, selling power stations — people can either have a contract or run it their way.

The average growth rate of the economy in the 1960s was almost seven per cent. Unfortunately, towards the end of this decade a debate started about the income distribution effect of the whole thing — there was a major controversy surrounding the 22 families.

DS: What deregulation measures you have taken?

SA — The deregulation measures are extremely important. We have removed all restrictions on industrial units. No sanction is required for any industry in the country. We have also deregulated foreign exchange. You can bring in and take out whenever you like. We have deregulated the financial sector — made them more market-oriented. We are now auctioning trade bills. Previously we used to force the bank to sell and buy trade bills up to 35% of the requirement.

DS: Would you elaborate a bit the financial reforms. You have instituted.

SA: Financial reform has many parts. The first is the financial sector reform. We have allowed new private banks. We have denationalised two of the five nationalised banks, namely the Allied Bank and the Muslim Commercial Bank. We have allowed 11 new banks in the private commercial sector, (plus 18 investment companies). So, for the first time the financial sector is open. There is competition and people do not have to come to the government for funds. They don't require permission. In future I hope they will not require permission for electricity, telephone and gas because these are also going to be privatised.

So the ideal situation is that an investor does not require to come to the government at all. We are gradually coming to that stage.

We had a mixed economy moving towards liberalisation. From '71-'72 onwards we began to become an over-regulated economy. We nationalised industries, particularly banks and insurance companies, and therefore we were unable to grow up to our potential.

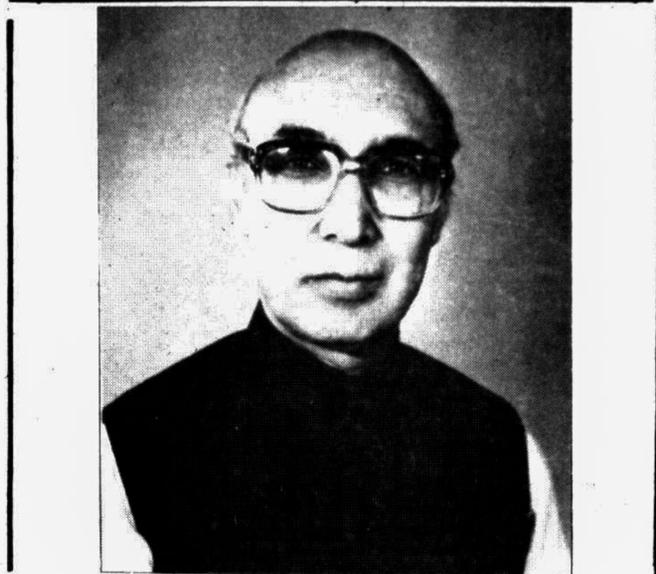
The last reform is tariff reform which means reducing the import duties to increase the profitability of export industries. An over protected industry can never become competitive in the market. So these 20 years we have over-protected our industries and so they can't compete, except those we have given incentives.

DS: Every policy has negative and positive sides. So what would you say would be the things you would like to watch out for i.e. the risks of these reforms?

SA: The policy framework alone would not bring success. We have to im-

Sartaj Aziz, the Finance Minister of Pakistan was quite nostalgic about the 60s, when Pakistan had started on a liberal economic path. 'Pakistan had ahead of Korea at that time, and if those policies were continued, Pakistan would have been one of the Asian 'Tigers'. 'From 1971 to '90 were lost years for Pakistan, he said. Nationalisation, over-regulation and government intervention in the economy destroyed the edge that Pakistan had in the early 60s.

A well known economist and author of several text books, Sartaj Aziz does not look at all like a man belonging to the world of finance. A fatherly figure, warm, ever-smiling and a gentleman to the core, he talked freely and frankly over two hours to the Executive Editor of The Daily Star Mahfuz Anam about the dramatic changes that he hoped would take Pakistan into the 21st Century — not as an on-looker, but as an active participant.



Sartaj Aziz

plement it properly. By the way, to add, we have also liberalised foreign investment. Foreign investor can set up to 100% foreign owned enterprise in the domestic market. If he wants to employ foreigners, he can. No work permit will be required and no restrictions on technical fees. Why should we regulate that? For the first time we have allowed foreigners to buy in the local stock market. Because of this a great deal of foreign capital is coming into our stock market.

DS: How much is coming in?

SA: The capitalised value of our share market was 50 billion rupees for 450 companies in 1990. Now there are 570 companies and the capitalised value is 260 billion rupees — more than 3 times in one and half year. If you look at the index for 10 years from 1980-1990, it went up from 100 to 280. Now it is 730. So the impact is already there. Money flowing in directly through certain foreign banks is about 250 million dollars which is about 60 billion rupees. So I would say about 25% of extra money has come in. The direct foreign investment, of course, takes much longer. The proposals are in the pipeline and we will decide on them soon.

DS: Would you say that the reforms you have brought about have generated a lot of interest?

SA: A lot of interest. Proposals and ideas are coming in everyday. But the

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prerequisite for success is infrastructure. Since we don't have that we are developing special industrial zones where we can concentrate on infrastructure and also provide security. The other most important aspect for success is the security of the environment. There must be stability. For that we have passed a law to protect these reforms. In fact it was passed by the senate last week.

DS: How successful are your reforms?

SA: We are improving as a whole because we are privatising the so-called sacred sectors, like roads and telephones. In two year telephones have doubled from 1 million to 2 million in Pakistan. We took the telecommunications out of the budget. It did not have enough funds so it grew at a slow pace, say 50,000 telephones a year. In the meanwhile the waiting list went up by 70 to 80 thousand. So we took it out of budget and said the telecommunication could borrow and expand. It has expanded to 1 million in two years. We have given contracts to one company for 300,000 telephones. The company will operate and in 7 years get its money back with profit. Then it will transfer the exchange to us. We have given contracts to five big companies for 200 to 300 thousand telephones each. All digital exchanges. By the end of this year we will have no waiting list. When we started we had 800,000 telephones and 700,000 on the waiting list. By the end of this year, any one who applies will get his telephone with 24 hours.

But roads, we are handling ourselves. We are building a major highway. For the

first time — doubling the highway between Karachi and Peshawar. We are building Indus highway on the west bank of the Indus for security and shorter route to Central Asia. We are building the first motor-way between Peshawar and Lahore which will eventually be extended to Peshawar. To give you an example: two years ago before we came to power, the budget for the road construction was Rs 170 crores. Last year it was Rs 500 crores. This year it is 1200 crores. So it has gone 8 times into and next time it will probably go higher. So there is a major expansion.

DS: So where is all this money coming from?

SA: Well from the budget. Because we are cutting costs in other areas. But while this infrastructure is expanding we will concentrate on a few special zones. In the short run we will use those to promote export.

DS: These will be like the Export Promotion Zones?

SA: Yes. But the conditions to be included in these zones will be easier. We won't insist on 70% products to be exported. If 50% products are exported and 40% foreign investment is shown then they can be located in the special zones.

DS: Returning to my question about dangers of your reforms.

SA: Yes, now the other side is. Obviously privatisation and free economy does lead to concentration of income. So we have to pay more attention on rural development and the social sector. Now we have a three year social action programme which we have started this year. This year on health, education, rural works, population, sanitation — we are spending 6.8 billion rupees. Next year it is 14.8 billion rupees, more than double. Next year 18 billion and in the next year it will be 20.5 billion rupees. Through the three year programme the lag we have in social sectors will be covered.

While you liberalise the economy you must also enforce the economic rule of law. This is how the system works. Its not free for all. There are certain rules, you must follow them and that is what I call the overall framework of the regulatory system. It takes time. The monopoly control legislation is in the making and the consumer protection legislation is also being prepared.

DS: You make such an eloquent defence of the new changes, and it sounds so logical, so natural, so obvious. Why didn't they come before? I'm talking of the whole sub-continent.

SA: First of all, in the 60s and 70s, there was an ideological movement partly as a product of the cold war. And there is absolutely no doubt, that in the case of these three economies — India, Pakistan and Sri Lanka there was a great deal of concentration of wealth and lack of social safety net in many cases. There was also a great deal of maldistribution of wealth.

Theoretically socialism is a superior system because the public sector controls the means of production. But society is neither wise enough, nor mature enough, nor selfless enough to make the system work. So except during the initial stages when every body's basic needs are met, a socialist system works. But as you go on, the system becomes too complex and the state sector cannot anticipate all demands and the political system is not

flexible.

It has worked in China because there was a strong ideological framework to replace the profit motive. But very few countries are able to create that. The non-material motivation have come either in the case of a war — you know you have brought for your country freedom movements. After that people are not motivated by an ideological framework. So the people who control begin to make money as it happened in Russia. The ideologies become a new class, as it happened in China. There is an inherent conflict between the objectives of freedom and the objectives of equality. The free system supports freedom but sacrifices equality. The socialist system supports equality by sacrificing freedom. But ultimately equality is lost because the economic pie or the cake is not growing. With a shrinking cake you can't ensure equality. So my conclusion is that society has not evolved to the level of maturity to introduce a true socialist system.

The free-market system at least works because it has some basic law of correction. This system is far more suitable for a regulatory regime to ensure that you put a social minimum and a social maximum and allow the system to work within that.

DS: Would you say that the regulatory system of the 70s was a reaction to the excesses of capitalism of the west.

SA: I think what they tried to practice in the early days was not capitalism but economic liberalism. In the 19th century we had capitalism which was not a part of the democratic process. At that time the democratic liberal framework had not yet evolved. The capitalism we experienced in the 19th century and the beginning of this century was without the political ethics that we have now, and so the system was very unappealing, exploitative, very ruthless.

DS: What we have now is capitalism with a heart.

SA: Yes, you can say that.

DS: In the 'new capitalism', what will be the role of the government?

SA: To create an environment for healthy competition to provide a good policy framework, to set up infrastructure for the private sector, to establish a social framework which will preclude excesses and in which initiative can thrive. This is the kind of framework is what the government should try to work towards. Of course there are pitfalls. One of the basic problems is that today's international environment it is not very fair.

Protectionism

DS: What do you mean when you say international environment is not fair?

SA: The most serious problem is that trade is highly protected. Trade is not free. It is somewhat of an irony that for all these years the western countries were breaching to us to liberalise and open up our economic and follow a free market system. Now that we have adopted this system they don't follow that advice themselves. They have restrictions on all the factors of production. A free system means no restriction on factors of production. Today labour movement is restricted, capital movement is restricted and movement of goods is restricted. There are fortresses, there are all kinds of restrictions on trade. It is a real tragedy that after all this debate, when country after country is now following a liberal market-oriented policy they don't have opening in world trade.

Even countries like Bangladesh who try so hard to compete in the world market find restrictions on its exports. If today they liberalised only the textile trade Pakistan would not need any aid after 3 years. For example we exported yarn worth one billion dollar last year. If we convert it into cloth, it is worth 3 billion dollars. If we convert that into garment, it is worth 6 to 7 billion dollars, if we convert that into good quality garments with Christian Dior, YSL (Yve Saint Laurent) labels it will be worth 12 billion dollars. So we can go from 1 billion to 12 billion dollar in five years. But we can't because there are quotas.

By the end of this year we will have no waiting list. When we started we had 800,000 telephones and 700,000 on the waiting list. By the end of this year, any one who applies will get his telephone with 24 hours.

Second point is that net aid-flow is shrinking. Our total aid flow is around 2.4 billion dollars. Our debt servicing is 1.7 billion dollars. So the net flow of aid is only 700 million dollars which is about 8% of our imports. So net foreign aid is financing only 8% of Pakistan's imports.

As I was saying, the international environment for growth is not as good as it was in the early 70s when the present Asian Tigers grew. We need a much more liberal framework in the international economy and in the conditionalities. I think the answer is that we have to stand on our two feet as we are trying to do in Pakistan. We are in fact reducing our total borrowing. Two years ago we were borrowing 3.1 billion dollars, which now stands at 2.4 dollars.

DS: What are your views on trade prospects within the SAARC region?

SA: SAARC has a great potential but the real obstacle is the political relations between India and Pakistan on the one hand and India and Sri Lanka on the other. I think once we solve these political hurdles then the potential for our co-operation is very great in technology, trade and cultural.

DS: Imagine that there was a political rapprochement tomorrow. What would be the areas where SAARC countries could have the type of trade and commercial relation that would dramatically change the present situation?

SA: If political problems are solved, then we should go for a free trade area within SAARC in which we liberalize trade between our countries. We will enormously benefit for it. For example, Pakistan is no longer afraid that Indian

goods will swamp us. Quality of our goods is much better and we can compete. You see, the EC has opened up their market. Now they all produce similar things and they buy each others products. This gives all the producers a greater market. As a result of which the cost of production goes down. So if you can start a free trade policy with a few items of trade, it would benefit us greatly. Even if we reduce our tariffs by 10-20 per cent we will be in a position to expand our trade. This should be considered in the next summit.

DS: So what is your prescription? Have a list of goods for which we have a preferential scheme?

SA: Yes. And for those items we would reduce tariffs.

DS: This being the first step?

SA: Yes. For example we are assembling cars — Suzuki, tractors — these can easily go to other countries. We have already sold tractors to Sri Lanka. If our tractors are cheaper than, say European tractors, and of good quality, then SAARC countries should buy these. We also sometimes have food surplus — rice, and other things. Take, for example, with ECO (Economic Cooperation Organisation consisting of Iran, Turkey, Pakistan and the six other Central Asian Republics) we have started a preferential scheme. There is a list of 40 to 50 items in which we will have special trading arrangement, including preferential tariff.

You see, the ideal situation is open global system. But if there is no open system and Europe becomes one fortress, and North America one fortress and ASEAN becomes another, then we cannot survive alone. So ECO is our block. Then we have another block — the Islamic block.

DS: With the trade prospects opening up in the ECO, is Pakistan's interest in SAARC waning?

SA: In the ECO countries, right now the political environment is better. With the joining of the six Central Asian countries ECO has really become very active. When SAARC starts improving we are ready to participate there. So they are not mutually exclusive options.

DS: The improvement in SAARC relation that you are talking about, Pakistan can help bring that about. Pakistan is an important player in SAARC.

SA: I think political problems need to be solved in any case, not just for SAARC or because we have ECO. It is very necessary to improve our security environment. Turkey for example, is a part of the European Community which is very active in ECO also. So SAARC and ECO are not mutually exclusive options. We can trade with different groups with different commodities. In other words, the two processes can be mutually reinforcing, they are not mutually exclusive.

DS: Do you think the economic forces can be allowed a free play pending the resolution of the political problems?

SA: I think beyond a point relations cannot improve if political hurdles are strong. Cultural cooperation has done better than economic cooperation in SAARC. But I think India is the dominant partner in SAARC and their responsibility to remove the hurdles in much greater.

DS: You said Pakistan is ready to open up economically vis-a-vis India, now that you are no more afraid that Indian goods will swamp your market.

SA: Our industrial structures are much more matured now. In the beginning we would have had a problem, but not now.

DS: Coming back to the original question on liberalisation. Do you think a liberal economic policy followed throughout would have been better for Pakistan? Was Pakistan ready for such an open economy?

SA: If Pakistan had continued in the 60s, route we would have been far better off. At that time we were ahead of Korea in terms of per capita income, structure of manufacture of exports, in terms of a number of exportable things. In the 70s we lost all our initiatives. Dynamism was gone. The 22 families disappeared from the country. We did not allow private initiative to flourish. The nationalised industries were not very efficient. There was over-regulation all round.

Of course if we had liberalised totally, the adjustments would have been far more difficult. We might have had upheavals as in Latin America, where the concentration of income had become unmanageable. To answer your question directly if we had continued on these policies of 1960s, without the other regulatory framework, we would have been in deeper trouble.

DS: How do you see the future for Bangladesh-Pakistan trade and economic relations.

SA: I think, on the whole, there are many things we can do. For example your requirements of cotton, cotton cloth for your own government industry could be met by us. We need jute — we still import jute from Bangladesh. We also import tea although Kenya is trying to eat into that market. But Bangladesh's industrial output has not grown very much. There is shortage of expertise and industrial capital. So if you had a liberalised private sector industry you could trade much more with Pakistan. In the present context there are many things we could buy — you have for example a fertilizer surplus, sugar surplus. But these are opportunities that the private sector can exploit much better.

DS: I think there is a problem regarding the trade export. There was a recommendation by your Prime Minister for the Import Trade Price (ITP) to be lowered for Bangladesh, but instead, it was made higher, making our tea less competitive.

SA: Well you see under the GATT we cannot give a discriminatory tariff to one country. The ITP is the price at which we import and that determines the duty. Lowering the ITP would mean discriminatory duty for one country. I mean one can do a little with specifications but basically it is considered as a discrimination. Under GATT you can't discriminate between two members of GATT. That is the basic reason. I told your minister that we would like to import more from Bangladesh. But you need more aggressive marketing here to sell more because you are competing on an equal basis. You need better salesmanship. Already there is some improvement in imports from Bangladesh but not as much as we would like.

DS—Thank you very much for your time.