PRIVATE SECTOR RESPONSES TO THE GLOBAL CRISIS: THE CASE OF PAKISTAN

Sultan Ahmed Chawla
ex-President FPCCI, Karachi

Introduction

This paper outlines the Pakistani private sectors response to the challenges posed by the global economic crisis which began in late 2007 to the national economy. Part one presents an analysis of the nature of this crises. Part two discusses current responses of both metropolitan and developing countries to ameliorate the worst effects of this persisting economic downturn. Part three presents the proposals the private sector has recently made to the Pakistan government to restore inclusive sustainable growth to the national economy.

I-The Nature of the Crisis

The crises that begin in the American wake of the subprime mortgage defaults in late 2007 is still with us and is usually interpreted as financial in nature and the typical policy response has been a somewhat mild tightening of financial regulatory regimes at the national level. This concern with restoring financial balances and shoring up threatened financial institutions has obscured several important structural characteristics of the global economy which have made this crisis so long lasting. It is these underlying structural characteristics that I will try to identify in this section.

The 2007 crisis certainly manifested itself as a financial phenomenon. During 2007-2009 several mega financial institutions were threatened by insolvency in the metropolitan countries. But very few were allowed to collapse and trillions of

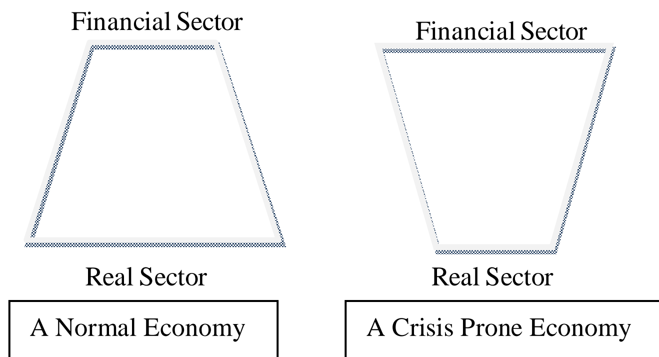
dollars of tax payers' money was pumped into the financial markets in America and in several European countries to salvage them. In response financial health was at least temporarily restored and macroeconomic growth prospects revived in the United States and at least Western European countries.

However, since 2009 we have been confronted by threats of sovergin insolvency as one Western European country after another finds itself unable to service its external debt. And of course several non emergent developing countries — including my own —- are also on the brink of default. Pakistan's external debt has increased by about 70 percent during the last five years while its capacity to service this debt has if anything stagnated.

Moreover, the bailout initiatives of the metropolitan governments do not seem to have done the trick. The recovery that is occurring in Europe and America seems more and more dependent on continued and indeed expanded public support — hence both the United States and the European Union have in 2010 continued to provide financial assistance of billions of dollars to sustain recovery and to prevent both private sector and sovergin insolvency.

This continued need for state support illustrates the inadequacy of the response to the crisis. The most obvious evidence of this inadequacy is the jobless character of the growth that it is occurring in the metropolitan countries. This shows that the efforts that are being made to revive national economies are by passing the bulk of the population — specially the poor. Thus capacity to participate in this recovery, through enhanced purchasing power is not being enhanced. Income distribution patterns which have become more and more unequal since the early 1980s specially in America and in the core European economies have if anything become more unequal during the crisis years. This is because the massive bailout programmes are invariably tax financed and represent a major transfer of resources from the general public to a small number of financial institutions whose shareholders and office bearers are among the richest people in the world.

It is inadequately recognized that sustainable financial recovery requires an upsurge in real economic activity — in industry, in agriculture, in trade, in services. If growth in the real sector is stagnant financial recovery is also necessarily unsustainable. The present crisis occurred primarily because of the overdevelopment of the global financial sector and this overdevelopment was itself a product of the stagnation of effective demand in the real sectors — agriculture, manufacturing and services. Effective demand in these real sectors depends crucially upon the growth in the purchasing power of the broad masses. The rich are not and cannot be major consumers of food products, clothes and educational services — there are simply too few of them to make a major impact in these markets (and often they are also ageing). The overdevelopment of the financial sector is a sure sign that firms are not finding opportunities for profitable investment in the real markets. This is exactly what was happening in Europe and America during 2002-2007. Real sector firms were replete with surplus savings — corporate saving rates were high — but opportunities for real sector investment were constrained by rising inequalities. And where effective demand was buoyant it was sustained by borrowing not by the growth of real income. Hence firms turned to financial markets for availing lucrative investment opportunities and their customers turned to financial markets for increasing purchasing power. Financial sectors became more and more overdeveloped in the sense that a mountain of financial derivatives were precariously balanced on a diminishing real base. The macro structure was stood on its head as the following figures show:



II- The Response

A striking feature of the response — both global and national — to the present crisis is the non emergence of a new policy paradigm. Unlike previous crises period — following for example 1873 and 1929 — no establishment voices are proposing a fundamental change in theoretical perspectives — there is no Marx, no Veblen, no Keynes in sight. Policy perspectives remain broadly unaltered and the emphasisis on the development of a more effective regulatory regime rather than a restructuring or overhaul of the system. The resort to neo Keynesian policies by the Bush / Obama and several EU regimes is of an adhoc, character and the underlying premises of this reform effort seems to be that state bail out and simulative efforts will necessarily be of a self liquidating character. A time will soon come when such 'Keynesianism for the rich' will no longer be necessary. More sophisticated prudential regulation of the financial institutions and an essentially symbolic — widening of the global structures of policy co-ordination will prove sufficient for ensuring sustainable recovery and "business as usual".

This approach does not address the fundamental structural deformity underlying this crisis which merely appears as a crisis of finance but is at its core a crisis of the relative overdevelopment of the financial sector vis-à-vis the real sector. The crisis is thus in its essence a crisis provoked by the growing inequalities fortressed by the global and national policy regimes that have been in place since the early 1980s, adopted both by conservative regimes and their social democratic successors in most metropolitan and developing countries..

If this view is correct — if the crisis is fundamentally caused by growing inequality — then those economies which have as yet been relatively lightly affected by the present crisis should take heed. Inequality is rising rapidly in several emergent economies — especially in India, China, Brazil and Mexico. Moreover, subsumption of these regimes within globalized structures of regulation — as articulated why the FSF, the IMF, and the WTO etc. — ensures that the same pattern of relationships is built between the public and private sector in these emergent

economies that exist in the metropolitan economies. This means that overdevelopment of finance will characterize the growth of these emergent economies — capital will be pulled away from agriculture, from manufacturing from services to money and capital markets both home and abroad and the gulf between the haves and havenots will widen. Moreover, since the poor and dispossessed in the developing countries are far worse off than the poor and dispossessed in the West, rising inequalities will have much more serious consequences as far as political stability and social harmony is concerned in their countries. For growth to be sustainable in the developing countries it must be inclusive growth -— this is a political and social imperative which no governing elite in the emergent economies can afford to ignore.

A regulatory state abiding by the rules endorsed by multilateral institutions such as the IMF and WTO will find it very difficult to encourage real sector development in the developing economies. Increasing inequalities have grown in tandem with the globalization of the macro policy regimes — indeed financialization is often seen as a necessary consequence of the globalization of national macro regulatory regimes. Thus if the developing countries are to develop a policy framework which focuses on the reduction of inequalities and the promotion of wide spread employment growth within the real sectors, the international macro regime must be redesigned to enable them to articulate such macro strategies. The view that the minimalist Nozickian state which confines its role to the regulation of private markets — both financial and real — is optimal in the sense that it enables every national economy to realize its economic potential is not vindicated by empirical evidence and is theoretically incoherent. International economic policy co-ordination must find space for according legtimization to what Samuel Huntington christened as "development states" in the 1970s. A developmental state does not confine itself to regulation. It actively participates in all markets to ensure that equitable and efficient development takes place on a sustainable basis.

III - What is to be done?

I will not attempt to outline changes in the global policy co-ordination regime that in my opinion are necessary to address

the fundamental structural disjunctures that have both participated and sustained this crisis. No doubt there are several people at this august forum much more qualified to speak on these issues than I am.

I am a representative of Pakistani business — I have just completed a two year term as President of the Federation of Pakistan Chambers of Commerce and Industry and am now serving as Vice President of the apex federation of business in the Central and West Asia region – know as ECO and grouping together Pakistan, Iran, Turkey and the ex Soviet Central Asian Republics. As President FPCCI I commissioned a comprehensive report on challenges facing Pakistan's manufacturing sector which outlined a set of policies that in our opinion the government of Pakistan should adopt if the manufacturing sector and overall macroeconomic growth is to be stimulated in a manner which makes it both inclusive and equitable on the one hand and sustainable on the other. I now summarize these recommendations.

- The FPCCI, President or his nominee should be included on the Board of Directors of the State Bank of Pakistan so that the formulation and execution of monetary policy measures should routinely and explicitly take account of their implications for industrial development.

- An initiative should be taken to promote universal banking in Pakistan. All financial institutions should be given targets for total long term industrial sector investment on an annual basis. The establishment of sector specific banks and capital market funds jointly owned by federal and provincial government with private sector participation should be encouraged in a) the engineering sectors b) textile and apparel sectors.

- The State Bank of Pakistan must reinstitute the formation of an indicative National Credit Plan on an annual basis. This plan should estimate the credit requirements of major manufacturing sectors if they

are to grow at the required rate so that the desired annual rate of growth of GDP is achieved. This will provide benchmarks against which the actual advances performance of the financial institutions can be systematically monitored.

- Public investment in large scale manufacturing and in mining must increase substantially. This is essential to reverse the near terminal decline of the capital goods producing industries in Pakistan. It is also necessary to increase the non tax revenue receipts of the government. As the South Korean and Japanese examples have shown public enterprise profit can become a major source of public development financing.

- Government should attempt to evolve management structures linking public and private ownership and control in both industry and finance. Much of the success of the miracle economies of East Asia was due to successful interweaving of public and private management structures at the level of the firm.

- Initiatives are required to rekindle the national project rehabilitation initiative — which has been all but abandoned. The problem of growing portfolio infection of the financial system cannot be tackled without successful project rehabilitation.

- A policy benchmarking system must be established within the federal ministries of industry and commerce to monitor changes in industry and trade specific policies of our key trading partners — the USA, the European Union, China the UAE and Saudi Arabia for example. This will identify opportunities and barriers in key markets and enable Pakistan to evolve "best practice" production, investment and marketing strategies. It can also lead to the

development of an appropriate policy support system targeting specific markets.

- The federal ministry of commerce should monitor WTO regulations and international quality standards continuously to identify scope for interpretation of these regulations and standards in a manner which is in accordance with Pakistan's national interests. We should acquire Chinese expertise for this purpose and learn from Beijing the art of developing national standards and regulatory frameworks which are within the ambit of global commitments but primarily designed to serve national needs.

- Integrating trade and FDI investment strategies can yield rich dividends in sectors such as textiles, pharmaceuticals and automobiles. FDI facilitation should be linked to export performance domestic resource use and technology transfer targets. The focus of trade and investment incentivization strategies should be on Pakistani communities resident in the Gulf, the USA and Europe. Institutional mechanisms for the establishment and strengthening of Pakistani Chambers of Commerce in the UAE, Saudi Arabia the UK and the USA with strong policy implementation capabilities should be explored and government funding should be provided for this purpose.

I hope that these recommendations make clear what sort of policy reform is required to initiate and perpetuate sustainable and inclusive growth in Pakistan. Pakistan is a relatively large developing country with a population of over 170 million. But it remains disparately poor with a per capita income less than $ 1,000 and a highly inequitable pattern of income and asset distribution. Pakistan has been hit hard by the crisis —— real GDP growth fell from an average of over 6 percent during FY04 to FY08 to about 1 percent in FY09 and 3 percent in FY10. In FY11 growth is forecast at about 2.5 percent. Pakistan suffered a major

financial upheaval in the first and second quarters of FY09 when the government had to spend billions of rupees to salvage major banks with foreign equity participation and management. Export growth in both FY09 and FY10 was also severely affected by the collapse in demand in Pakistan's major export markets — the USA and West Europe. Both direct and portfolio investment plummeted during the crises years. On the other hand, the government's external debt grew rapidly and will exceed $60 billion by the end of the present fiscal.

Since 1988 Pakistan has been participating in IMF stabilization programmes – the current one has been extended up to Sept 2011. The commitments under these programmes have been investment growth constraining. During the crises years private investment has stagnated and public investment has virtually disappeared from the commodity producing sectors. There has been almost no macroeconomic structural change. The share of manufacturing value added in GDP has remained stagnant at 12 percent for over two decades. Capital goods industries have been destroyed. Pakistan, one of the leading textile exporters of the world, produces no textile machinery.

The private sector calls for the state to take on a development — not a hands off arms length regulatory — role to institutionalize sustainable, inclusive growth. There must be a major revival of public industrial investment. Public and private corporate management structures must be interlinked. Trade and investment strategies must be integrated. The priority policy concern must be the promotion of domestic demand. A fundamental orientation of the macropolicy paradigm is required if Pakistan and most developing countries are to increase them, crisis resilience and to institutionalize sustainable inclusive growths which realizes their full economic potential.