

Distortions, credit and durables

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A motorcycle costs about Rs80,000 in Pakistan, while the per capita income for Pakistan, in year 2002, was about Rs30,000. So it would take three full yearly incomes of an average household to buy a motorcycle. Baleno and Citi cost around Rs800,000. So the income of almost 27 years is needed to buy such a car. These are surely very high.

Contrast this to the situation in say the United States. Assuming a per capita income of about 30,000 dollars, we can see that getting a mid-sized car or a good motorcycle would only cost a fraction of the yearly income. Why should there be such a contrast and does it tell us anything interesting?

It does. It tells us that these goods are too expensive in Pakistan, compared to incomes. And it also tells us that if we need credit markets to finance the purchase of these and such goods (like houses) in the United States, the need for these credit markets would be even higher in a country like Pakistan where the costs of these goods are much higher.

The fact that prices for some of these goods are high in Pakistan, in terms of average incomes, compared to say the United States, hides two separate facts behind it. One is that our incomes are much lower in Pakistan so that real prices of these goods, when purchasing power is taken into account, will remain high for us. The other aspect has to do with the fact that prices of some goods might be higher in Pakistan due to some other reasons. It is this fact that we focus on more, though keeping the first one in mind.

This price differential, where things are more expensive in Pakistan than in the US, cannot be true for every good. Think of haircuts. An average 'guy' haircut costs only say Rs100 or Rs200 in Pakistan. It costs a good 10-20 dollars in the United States. Haircuts are much more expensive in the States.

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The government can work on removing distortions so that goods expensive in Pakistan, compared to other countries, can become cheaper.

ket. The demand for cars is high, the supply is much smaller, there are very long queues of people waiting for cars, the premiums on buying from the open market are very high, and there are significant rents to having insiders in these car manufacturers. The manufacturers, the automobile part suppliers, the entire vendor chain, and the dealers are having a field day, but it is the poor public that is paying. They are not getting the cars they want, they have to wait a long time, they are paying extra for poor quality cars, and have to live with the fact that where in the rest of the world they could have had access to much better and cheaper cars, here they have to live with the consolation, that in the name of national contribution they are making the 3-4 families of the car manufacturers and their multinational partners richer.

The automobile industry is a much-discussed example right now. But what is true there is also true of other industries. Motorcycles are more expensive in Pakistan, in relative terms, for the same reason. And so on for a lot of electronic goods and other consumer products that are being made in Pakistan and the government has had to protect local producers by erecting import or other barriers to their free movement and trade.

This is not unique to Pakistan. In fact, in a lot of

other countries, can become cheaper. But if the aim is to give larger and larger segments in Pakistan access to these goods, the one price situation alone is not going to be enough. Since our mean incomes are much lower than in the States, we will need to have very efficient, and almost perfect credit markets to allow more and more people to have the ability to buy these products. The recent moves to open up banking to consumer durables and to open up the credit-card market to more people is thus a step in the right direction, even though it was forced on the banking system due to other reasons.

A person making say Rs8,000 a month can only pay about one thousand or so a month to finance the purchase of any durable. This is more than 10 percent of his income already. A car is clearly out of her reach. If a car costs even Rs500,000 and she can only pay Rs12,000 a year, this will just take too long, forty years, even to pay the cost, apart from any interest charges. But if a motorcycle costs Rs80,000, then this person can have a shot at buying a motorcycle in about seven to eight years. If the government works to bring the prices down to say Rs40 to 50 thousand for a bike, by removing the price distortions, the person could get the bike in 3-4 years. And a person with even lower income could have this access. The same is true of other consumer durables.

But the imperfections in the credit markets are currently such that the extension of credit to all groups who have decent incomes is still difficult. Due to problems with loans for industrial investments and higher cash inflows banks have been beset with excess liquidity problems. This has forced them into consumer banking, but they are finding it hard to find groups that have high enough incomes and are decent credit risks as well. Credit cover has been extended to a lot of higher-level government employees, army personnel, employees of large corporations and so on, but they form a small class within Pakistani population. There are significant groups, small traders, craftsmen, workers in small and medium enterprises, administrative staff in smaller organizations or lower tier administrative staff in even larger organizations that do not have such access. Banks find these groups to be too risky. But we have

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These price differentials should come as a surprise to students of economics. They learn that for goods that are similar or identical, and there is little real or perception-based product differentiation, there should be one price for all such products (purchasing power parity (PPP) hypothesis). Yet, even for comparable cars and comparable haircuts we find that prices are quite different across countries. And even where products are not the same, say on the basis of quality, the price differentials are too large to be explained by just the quality differentials. If prices diverge, there must be distortions in these markets that are making the prices diverge.

Distortions are one of the first culprits we look for in cases where markets are not delivering what they are expected to. And there are significant distortions indeed across markets. Price divergence implies that goods and services, for which we have price disparity, must be ones that are not being traded openly. We make allowance for price differentials that might exist due to differences in the cost of transportation, but when differentials are larger than what can be justified due to differences in cost, these can be explained through trade distortions.

Difficulties in trade explain a lot. There are very high duties on the import of new automobiles in Pakistan, and import of secondhand cars is not permitted as such. Both the high tariff and the ban impose significant distortions in the automobile mar-

erecting import or other barriers to their free movement and trade.

This also explains why haircuts and a lot of other services that depend on human resources are cheaper in Pakistan. We have plenty of people and this higher population puts a downward pressure on the prices of all services that do not require a very high level of skill, or a very long and expensive process of apprenticeship. So even though in services where we have need of people who are very well trained, like brain surgeons and good quality economists, we have a scarcity and they do command higher prices, but where the process of training is relatively short and/or cheap, we have plenty of people. In the United States all 'services' that require human input tend to be more expensive as they do not have the same population dynamics. This is, by the way, the reason why durables have a longer life in Pakistan: we get them repaired as servicing is cheap. In the States if something is broke, one just tends to replace it. So we see a larger proportion of older cars still plying on the streets of Pakistan than we do in the States. If people could move freely across countries, prices of all goods, barring transportation costs, will equalize, and incomes for people, in the same professions, would also equalize.

So, where the government cannot do much about the movement of people across borders, it can certainly work on removing distortions so that the goods that are very expensive in Pakistan, compared to

larger organizations that do not have such access. Banks find these groups to be too risky. But we have to find ways of reaching these groups if consumer credit is to be the way to address the problem of accessing durables.

I hear of colleagues who get phone-calls from credit card sellers and marketing people of banks asking them to have another credit card, or asking them to buy another car, television and so on. At the same time there are so many people who could possibly afford these goods if the credit market could just reach them. And if the government worked on removing some of the distortions in the pricing systems of durables the access issue could become easier to resolve.

The durables that we have talked about, from cars and motorcycles to televisions and refrigerators, are not luxuries; they are recognized as necessities. They are part and parcel of modern living and are 'required' to lead a productive life in these times. The state has to ensure that it does everything to facilitate the population in accessing these products. This requires a two-pronged strategy, given our level of income. It requires that the State works on removing distortions from these markets. And it requires that the State should do its utmost to facilitate the development of credit markets so that more people, who can afford to, can access these products.

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