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## Managing Growth with Stabilization III



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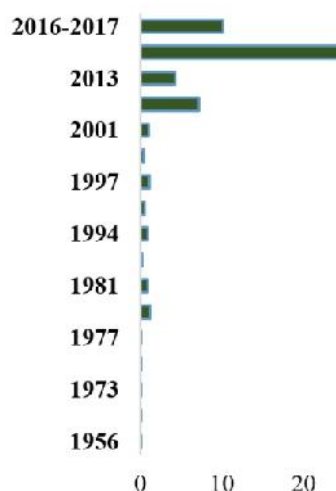
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- How should Pakistan achieve durable adjustment without joining through crushing austerity of recent years?
- What can be done to achieve growth acceleration even when developing a stable economy?
- What are the major mistakes made in the last 3 decades of adjustment program in both design and implementation?

As Pakistan's debt journey began in the year of 1956 with USAID and through massive loans Pakistan did not achieve the desired long-run growth with stabilization. Debt history of Pakistan clearly shows that Pakistan has two to three IMF programs in every decade, shows in Figure 1. Since, through massive loans instead of achieving long-term growth and stabilization Pakistan is facing deficits and a severe unemployment rate among young graduates which is around 33 percent estimated by the PIDE. This webinar enlightens us to understand what can be done to achieve the growth acceleration, what are the major mistakes made in the last three decades of

adjustment programs in both designing and implementation by the policy makers. Further, how should Pakistan achieve durable adjustments without crushing austerity in recent years?

Figure 1: Amount of  
Loan (Billion \$)



How we will move towards a stable long run path from an extraordinary set of difficult short run initial conditions?

To achieve the growth with stabilization we need to focus on the key prongs of long-term strategy to manage the growth with stabilization. The first is the whole area of progressive taxation reforms which has remained elusive last year and effort was made to broaden the tax base and remove some tax expenditures. But at the end unfortunately we were only able to achieve less than half of the initial growth rate that was anticipated. The second most crucial element in this regard is the rationalizing of

government size which is much embedded in the macroeconomic framework that has been presented by the IMF. Here the issue is how to be rationalized the size of government particularly of the federal government after following the 18th amendment. And funds have suggested a downward trend in the defense budget over the next five years, so, will we be in the position to do this? **The Changes** in expenditure priorities is the third most important area of impact to accelerate the



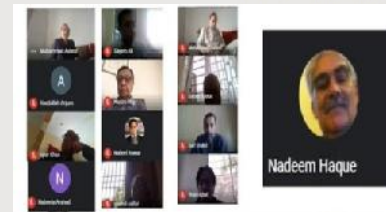
growth. It is truly tragic that the spending on water resources is reduced to the half level in terms of percentage to GDP ratio, when there is a need to focus more on water resources development. The absence of effective development spending can cause the constraints on growth potential. There is dire need to ensure enough

financing in those priority areas to accelerate the long-term growth with stabilization.

The next element is the export-led growth in which Pakistan unfortunately has a big failure to promote its export. It is quite surprising that the exports of Pakistan remained unchanged from the last seven to eight years. To support the long-run growth with stabilization the policy makers must consider how we accelerate exports, how do we diversify our exports beyond the traditional dependence on low value-added textiles and how do we ensure balance in our current account.

Finally, in terms of individual and planning process and the strategy. It is extremely important that some key sectors should be identified, like agriculture, construction and so on. These sectors have strong backward and forward linkages and promote a measure of inclusiveness in the growth process. These are the few key issues which we need to focus to achieve the long-term strategy to manage the growth process with stabilization. Furthermore, there are two most critical elements in a strategy: mobilization of resources, revenues and exports.

Higher revenues and exports are very important factors for a medium to long-run strategy to achieve the higher rate of growth with stabilization.



In the context of macroeconomic framework there is always a question: how do we prepare our own macroeconomic framework instead of relying on the framework of the IMF. The other associated question is that should we change our program design or not as the program design has remained unchanged. If we look at the current situation the whole world turned upside down from the stabilization program. In the time of crisis talk about stabilization is not the right way as every sector of the economy including production, consumption and supply chain and so on, facing disruptions. This is the time to think about how we make the workplaces operational and how long it will take and what kind of strategy the government



should adopt to normalize the things instead of still focusing on austerity. The banking sector should have to gear up the economy in different areas such as SMEs, construction and so on as they have plenty of liquidity to boost the economy particularly in the period of COVID-19.

In addition to the above, our program design is based on very heavy taxation as our economy is tax led. The major focus of almost every government is to increase the revenues through excessive taxation. A plethora of taxes were imposed by every government not limited to the withholding taxes, presumptive taxes and full & final taxes. All our programs are tax led and growth is the second concern always and considered as residual by our policy makers. On the other side tax is a huge documentation cost, so, the question is should our program be tax led?

This is the one of the fundamental concerns in the context of current program design which relies heavily on a big increase in the tax to GDP ratio, resultantly, which provide the resources for expansion particularly in development spending which ultimately accelerate the process of growth.

According to the current program design, the expected tax to GDP ratio is 2.3 percent of the GDP in one next year. On the flip side, our tax system has been captured by the report on the sugar crisis and the price increase which happened for the first time in the history of Pakistan. The second issue in our tax system is that most of the taxes are collected from the trader. If we look at our neighbor India; only one city Bombay is collecting five times more property tax as compared to the total national property tax of Pakistan. Therefore, there is an urgent need for structural reforms in the current taxation system.

The Greece program is one of the successful programs led by growth not by austerity, so, the question is can we have the program led by growth instead of tax led. For long run growth and stability, we need a huge investment particularly in the infrastructure sector in every city. If we look on figures there is 50 percent public investment and only 15 percent is private investment. Therefore, there must be public private partnership at a higher level to stimulate the growth for a long term period. There are particularly two or three

areas that can contribute in growth led strategy.

The first is the construction sector not in terms of infrastructure but in the context of development of water resources etc. and the private construction too. As now the government has introduced a construction package by providing a wide range of supply including a tax amnesty and free environment. The issue lies on the demand side which is what the builders will construct if there is no need for housing in the country. If we want to follow a growth led strategy then there is a need to focus the banking sector on developing housing finance which is very low around 0.6 percent. In the current system we have some issues like we don't have low cost housing relatively long-term, we didn't develop a proper foreclosure legal framework. As the government rightly identified the construction sector which has linkages and could become one of the focal points for growth strategy.

In the present era innovation and entrepreneurship are considered as major drivers of long run growth and stability. So, we need to focus on innovativeness



and dynamism; our SME sector contributes a lot in the growth but unfortunately this sector has been hopelessly starved for credit and one of the ignored sectors in terms of credit financing. Again, in terms of SMEs financing our banking sector is not promoting and investing in this sector of the economy which is almost counted for the 40 percent of the economy. What the banks are doing is they are just investing in PIBs for more money with zero risk. For a long-term growth strategy along with others we should develop an innovative SME sector.

Pakistan should have a growth led strategy but unfortunately Pakistan government didn't propose any growth led strategy. The International Monetary Fund (IMF) is looking for it but the Pakistan government didn't want a throat. Now, in this strategy what would be the key structural reforms? As already mentioned, from the political economy perspective there should be structural reforms in taxation system, preferential, input-output pricing that is one key area of structural reforms. Here the question is, is it politically feasible?

The other key area of structural reforms is the

power sector in terms of merit order of plants. As the power sectors problems have reached a dimension that they are beginning to be a limiting source to growth in terms of financial liability (which is mentioned as contingent liabilities in budgetary documents and nobody wants to talk about it) and how can we build markets for the power sector. We should also focus on cost plus price mechanism rule of NEPRA. These are some fundamentals step we have to take to ease the process of long-term growth.

As inflation is one of the most important factors to accelerate growth and we have an inflationary economy. IMF set an inflation target of eight to five percent and the Phillip curve clearly demonstrates that there is a trade-off between growth and inflation. So, the questions are, do we need to chock off the growth with real interest, do we need a higher inflation target and where is the sacrifice ratio of low growth rate?

There are some other factors in which we are lacking and that have a strong and long-term impact on growth. One of them is, Pakistan's lack of concern for human development and history exposed that we didn't

spend a fair amount of money on developing human capital. If we compare our level of human development with very small and young countries like Bangladesh and Nepal, we will be disappointed to see that we have a lower level of human development as compared to these nations. Unless we don't train our people in innovation and technology, we cannot achieve the higher level of productivity which ultimately creates maladjustments in the growth process. So, there is a need to spend a handsome amount of money on training and soft skills for the long-run stable growth rates and fortunately this program also supports this.

At last they give emphasis to strengthen the planning commission once again to negotiate the fund programs and to develop the growth led strategies. Further, the 18th amendment has extremely strong planning development departments or boards in the provinces which is quite required for the growth. The critical element in this within the federal government is the absence of the role of think-tank institutes like Pakistan Institute of Development Economics in the planning process. We need more



participation from the civil society and the key institutions of the government universities to develop more critical thinking for growth led strategies. The growth led strategies have to be more broad-based and transparent. On the other hand, if we compare governance indicators to countries like Vietnam, we will see a clear collapse of governance in Pakistan which is also a hindrance to move towards long-term growth with stabilization.

Therefore, the only solution is to do the reforms as the Prime Minister has already said this is the best time for doing reforms particularly the time period of COVID-19.

To sum up, Pakistan is facing a lot of challenges to achieve long-term growth with stabilization not limited to the taxation system, land management system and banking sector. One of the prominent challenges is the absence of growth led strategies along with lower levels of human

development, lack of innovation and technology and absence of the academic institutions in the planning process. Therefore, there is a need for structural reforms in the taxation system and to spend a prestigious amount of money in resource development and research & development. Furthermore, to achieve the higher growth we have to promote and develop innovative SME sectors.

