



Webinar Brief No. 4:2020

Managing Growth with Stabilization

Series

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How should Pakistan achieve durable adjustment without going through austerity?

2

• What can be done to achieve growth acceleration even when developing a stable economy?

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What are the major mistakes made in the last 3 decades of adjustment programs in both design and implementation?

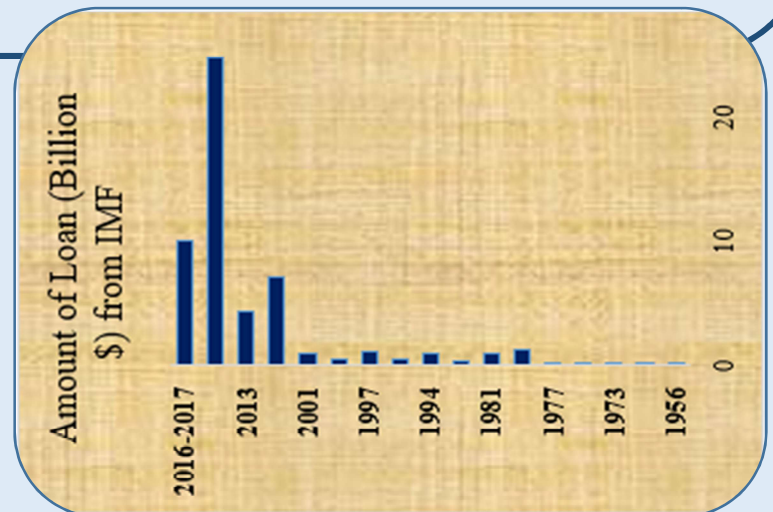


Dr. Nadeem-Ul-Haque

Takeaways



Pakistan has been struggling hard for stabilization and strappingly relying on IMF programs for decades. Pakistan is extensively running after loans with the hidden conditions and now the state reflects that Pakistan is under pressure of approx. 53 billion debt. IMF internal evaluation report depicting that three things which lead towards austerity mainly include design failure, implementation failures related to government and institutional decay. Now the problem lies in the capacity issues especially in FBR, Ministry of Finance and Planning Division and finally the tax policy which is an absolute disaster of all. Considering the last program where offering a number of waivers, appreciated exchange rate, loss of reserves that built up debt during the program, increased energy prices and increased circular debt creating mess in the energy sector. Unfortunately, all these factors reflect the declining long run growth rate as well as investment rate i.e. Pakistan is lowest in Asia. Now the question arises that when and how we will be able to attain durable adjustments? What would be the ultimate objectives? Can our economic policy be able to refurbish all? Tax regime is happening at the cost of growth and employment. This is in fact a huge burden on the economy leading towards the declining GDP, killing investments and ultimately high fiscal deficit.



Managing Growth with Stabilization I



Masood Ahmad (President, Center for Global Development, USA)

Key Messages

- Mr. Masood Ahmad explained the relationship between stabilization and growth. He highlighted that economic stabilization can have symmetric objectives but the COVID-19 shock encountered an unanticipated collapse in demand and output and all related response programs are working hard to stabilize an economy.
- Traditional objective of economic stabilization is to restore macroeconomic stability by rebuilding foreign exchange reserves and reducing the current account as well as fiscal deficit. It can only be possible by enhancing the exports and reducing imports through change in exchange rate.
- Coming up to the current account issue, Dr. Masood argued that Pakistan has not enough exports. The fundamental problem associated with exports is that it totally relies in the hands of the family businesses of Pakistan and they don't want to let go of control.
- There are no consolidation or bankruptcy laws in such cases. Moreover, Pakistan's export industry has no FDI and that industry is only commodity-based; not supporting the mega-orders exports.
- So, Pakistan has to seriously re-think on the exports, regenerate it and make our industry competitive. Third factor i.e., saving and investment rate which is also extremely very low. For this purpose the financial sector has to be revamped. This could only be possible to start with a good implementation plan, forward road map, good governance and good implementation.
- The key points are that the IMF is effective in doing its job of inducing stabilization but the track record of laying the foundation of sustained structural growth is very vague. Stabilization is mostly being achieved through import compression resulting in well-restoring of foreign exchange reserves. Similarly, fiscal adjustment has heterogeneous impacts on growth depending on several other economic dimensions. Last of all, growth will come from structural reforms and a sense of ownership.
- In the case of Pakistan, there is a dire need to identify the constraints, stick to the fundamentals and chart a clear path with political willingness and accountability.

At the end, Dr. Nadeem counter confirmed the saying of Mr. Masood that in Pakistan nobody is interested in growth and elite-captured people are the major hurdle hunters in the way of growth. The only point of concern is that when will the people of Pakistan start thinking and will demand growth. This is the only way that ensures Pakistan towards growth and stabilization.

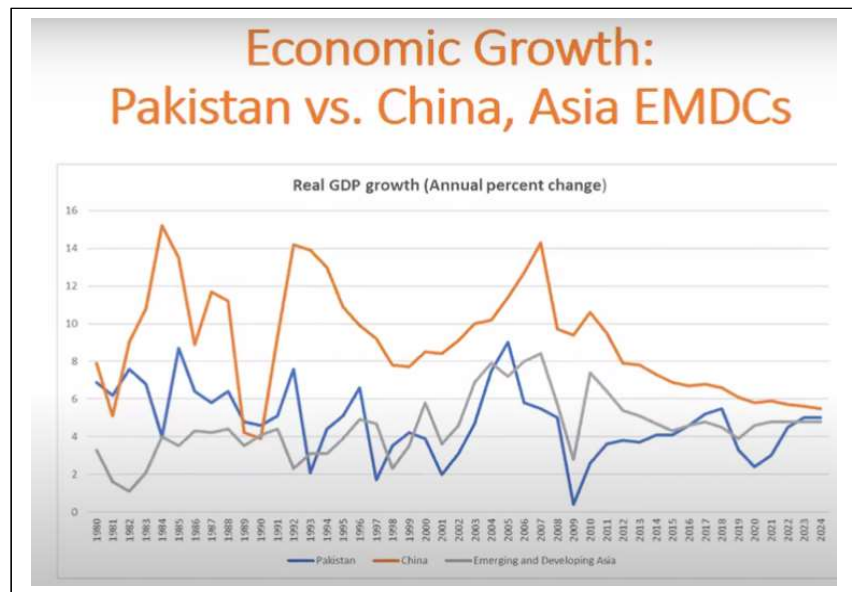


Managing Growth with Stabilization I I



Dr Adnan Mazarei (Senior Non-Resident Fellow, Peterson Institute for International Economics)

The growth pattern of Pakistan is not stable rather fluctuating from the last few decades. For the first time in history of Pakistan, a negative growth rate accounts for -1.5 is projected by the IMF, after the year 1952 when growth rate declined to 1.8% due to exogenous shock to agriculture. Moreover, the projections of the IMF for the year 2021 and further are optimistic. In the past, as compared to China and other developing Asia, Pakistan could have done a great job. For instance, the GDP per capita of Pakistan was twice as high as China in 1990, however, in 2018, the growth rate of both countries became closer as China moved faster.



Key Messages

- There are a lot of factors which deteriorate the geopolitical, political and historical shocks, geography, governance and economic incentive structure. Further, Pakistan has not succeeded to control export diversification, except the year 1984, after that the declining trend again started particularly in agriculture and textile.
- Another factor contributing to the low rate of growth is the absence of Pakistan in global value chains. Although, Pakistan's participation in global chains has improved relatively to past years, as it was 22 percent during 1990-2015, while Vietnam was way ahead with 40% participation rate.
- The backward participation was negative as it stood at -2% indicating the decline in sophistication of Pakistan's exports. Whereas, the changes in forward participation was good but not significant as compared to other countries.

- Moreover, it also shows that other countries rely on inputs while Pakistan contributes in value-added.
- Pakistan goes through repeated macroeconomic instability and adjustment cycles and the major reason for this is more emphasis on stabilization rather than growth. We often neglect the issue of growth because we repeatedly get confronted with cycles of stabilizing and lack of reforms to address the roots of that instability.
- One of the main factors behind it is the over-reliance on geopolitical rents and IMF financial safety nets. The reason behind focusing on stabilization rather than growth is the IMF programs that are more stabilization and crisis management oriented rather than growth oriented.
- Unfortunately, whenever we have growth over 5%, we have gotten into macroeconomic instability or currency issues. We have been growing slowly because there are a lot of law and order issues in Pakistan and the state being weak has not been able to take care of the law and order situation. Similarly, in the past violence incidents of terror discouraged international businesses from coming to Pakistan.
- Pakistan has not grown as fast as other countries. So, there is an overall need to understand the non-convergence puzzle and focus on growth. This requires balanced breathing space from stabilization.
- There is a dire need to identify the root cause of instability in growth. These instability cycles mainly, caused by excessive budgetary spending or other balance of payment problems.

To overcome this problem, there is a need for a social contract that delivers shared economy prosperity, which focuses on building economic strength, and less reliance on geopolitics. Government should cut down the subsidies which were given to the elite such as the power and gas sector and put them into health, education and research & development for long term positive growth to achieve economic prosperity.



Managing Growth with Stabilization III



Dr. Salman Shah

(Advisor to the Chief Minister of Punjab on Economic Affairs and Planning & Development)



Dr. Hafeez Pasha

(Former Finance Minister, Govt of Pakistan)

Key Messages

- 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.
- 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.
- 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.
- 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.
- The second issues 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.
- 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.
- The third area is structural reforms. 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.

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.



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