PAKISTAN'S ECONOMIC RECOVERY:

The Way Forward

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All-time high inflation rates and record fuel prices have put households under tremendous stress. Add to this dwindling foreign exchange reserves and the devastating floods of the past summer and prospects of these pressures being released in the near future remain slim. And while the scale and depth of the current economic crisis is bigger than any we have previously experienced, it's nothing new. So why do we consistently go from one balance of payment crisis to the next? And what reforms need to be enacted for a permanent fix?

Our recurring current account deficit is due to our import bill far exceeding the export earnings. In this, it is the value of our import of petroleum products and of heavy capital equipment that drive up the bill. There are some exogenous factors to the high bills that we have faced in the past few quarters: the Ukraine war and the subsequent spike in petroleum product prices has certainly drastically reduced our fiscal space. Yet, of greater concern is the internal mismanagement of resources.

Our oil and gas reserves are ranked 52nd and 29th in the world respectively. Yet, severe underpricing of gas means that we are fast running out of gas reserves while inadequate development of refineries implies that we import more refined oil relative to the cheaper crude-oil driving up our import bills. In the same vein, our reliance on capital intensive imports stems from the poor state of our industrialization where we continue to rely on import of heavy capital equipment due to a lack of adequate facilities and know-how to manufacture these locally. While it may be unreasonable to expect that any country would be able to locally produce and substitute all of its heavy capital imports, our decades long inability to do so at even a rudimentary level has come at a heavy cost. What we see is a heavily protected local industry, a failed import substitution strategy and a tariff and subsidy structure that favours selling in the local market as opposed to focusing on and building high value-added manufactures and exports.

A recent report by the World Bank shows that while the average Pakistani worker produces 40% more value added today than 30 years ago, productivity of the Polish and Vietnamese worker has grown by 5 and 8 times faster respectively. The Vietnamese comparison is especially telling since its economic structure, particularly the nature of its exports, in the 90s was not much different from Pakistan's. Yet today, it has diversified away from primary exports. Not only has it become a regional hub attracting some of the biggest names in electronics to set-up shop, but the country has also successfully put in place the necessary pre-conditions to create and multiply the backward and forward linkages such that domestic firms have also grown.

So, what are the lessons for Pakistan?

The first is a reduction in distortions. Tariffs on imports are the mainstay of protectionist strategies, aimed at allowing the local infant industry room to grow, mature, and eventually become internationally competitive. The issue however is that as these tariffs get extended, which has been the case in Pakistan, the incentive to make productivity gains reduces. Not only are firms not incentivised to reduce inefficiencies through optimal recourse allocation but there is little need to engage in R&D or to innovate. Phasing out these duties requires a deep dive into the political economy driving them as well as an understanding of connected effects. Who are the groups lobbying for extensions in tariffs? What are the pressure points that these groups leverage? Are there welfare reducing considerations if tariffs are removed? And how do these compare to long-run benefits?

Second, and related to the first, is foreign direct investment. In order to truly see the breadth and depth of productivity gains and a diversification away from primary exports, investment – and that too, business investment into Pakistan – must be made more attractive. This would not only allow us to make the global and regional linkages integral for successful global trading, but also allow training and expertise to flow into the country. This is particularly relevant for innovation and R&D. Pakistan ranks 108 out of 190 countries in the Ease of Doing Business rankings. Although we do not have as harsh or strict a regularity environment as some other countries, poor property law enforcement along with political and economic instability make it risky for foreign investment to come in. And while there is a dire need to make wide judicial reforms, it is equally essential to chart out a clear economic reform plan. The latter would send a clear signal to the international community regarding the country's seriousness in getting its macroeconomic fundamentals in order.

Third, we cannot sustainably resolve our persistent balance of payment crises without focusing on our human capital. Growth in export values requires a move up the value chain where terms of trade are better. For this we need to incentivise firms to orient themselves outward while filling capital and credit market gaps. The latter would allow firms to scale their operations and optimise capital to labour ratios. All of this would allow the output produced per unit of labour to increase. But in all this, the quality of labour also matters. Greater value addition requires insight into new ways of combining existing inputs as well as new techniques of production. Competitiveness in today's fast-changing global economy requires an understanding of marketing and branding. This is a requisite even when it comes to primary goods exports for which farmers are acquainted with quality assurance protocols. All of this requires knowledge and expertise. It also requires an ability to learn quickly and pivot in case of shocks or crises. A high-quality education system cultivates all of the individual traits needed for such transitions. Article 25A which guarantees education for all is a good first step. We also need to invest in quality. As per the latest reports tracking education quality, the gaps in reading, writing and mathematical ability are widening with each subsequent year. Some possible interventions to tackle these growing gaps include tracking teacher attendance while also increasing community involvement in schools.

Finally, we need to pay attention to labour force participation rates. Formal labour force participation rates for men are at 78% and for women are at 20%. While men's participation rates are in line with what is found in other countries, women's are among the lowest in region. Granted that the official participation rate, even in its augmented form, does not fully capture women's participation in the informal economy, we cannot deny that the full potential of women's labour is not being harnessed by the economy. There are too many gaps in women's financial and digital inclusion, their access to credit and capital markets, their educational achievements or the trainings that they receive, to name just a few. Until we find meaningful ways to address these gaps that are mindful of the safety and mobility concerns that women have and the high reproductive burdens they face, our labour force productivity can never fully be realised.

Clearly then, there are many steps to be taken. The severity of our current situation is such that it is imperative that we make headway on the issues highlighted in this article, as well as those catalogued in several other pieces, simultaneously. We are no longer in a position where we prioritise one aspect of the economy while keeping the rest on the backburner. We know which levers to pull, and have known for a while.

It is high time we took action.

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