Recovering from CURRENT ECONOMIC WOES

Karim Khan

Amid political and economic uncertainty, Pakistani economy is faced with a number of structural challenges that needs to be fixed in order to have financial or operational viability. First, we have low growth prospects in the near future, aggravating the precarious situations of unemployment and poverty in the country. Second, we are faced with persistent current account and fiscal deficits which are not only upsetting our budgetary process but are also escalating our risks of default on external front. Third, we are faced with relentless inflationary pressures, enhancing vulnerabilities of a sizable fraction of the populace.

With regard to existing situation, the growth outlook for financial years 2022-23 and 2023-24 is not encouraging amid the devastating effects of deadly floods and Russian-Ukraine conflict. According to the latest estimates of the World Bank, the growth rate is expected to range between 2% and 3.2% for financial years 2022-23, and 2023-24. This would create further dents on the hazardous situation of unemployment in the country, with 31% of our youth are currently unemployed as is recently estimated by a PIDE study. Likewise, it would intensify the situation with regard to poverty, with 39.3% of the populace is under the lower-middle-income poverty line ($3.2 per day) as is recently estimated by the World Bank. On external front, our current account deficit has been projected to be 4.6% and 4.3% of GDP for financial years 2022-23 and 2023-24, respectively. Similar is the case with fiscal deficit, with a projected fiscal deficit of around 7% of GDP for financial year 2022-23. These economic imbalances have collectively surged public debt of the country, with domestic debt reaches to Rs. 32.93 trillion and external debt reaches to around $100 billion, both amounting roughly 78% of the country's GDP.

The situation with regard to foreign currency reserves is also alarming, with reserves held by the SBP stood at $2.9. billion as of February 10 which is the lowest since February 2014. These statistics are translating into a high level of uncertainty, especially amidst the recent deadlock with the IMF on general sales tax (GST), utility prices, circular debt, Petroleum Development Levy (PDA) together with unsatisfactory concessions from the friendly states. Further, current inflation rate in the country is around 27.55%, with rural areas are the most hard hit with an inflation rate of 32.26% compared to 24.38% in urban areas. In particular, the food inflation of around 43% has made the lives of majority of the population extremely vulnerable amid domestic and global supply chain disruptions and dwindling incomes due to floods.

Can we come out of the current economic woes in a pragmatic way? I would like to posit that, yes, we can avert the risks of default and, also, we can put the economy on a sustainable growth path if we introduce structural reforms in true letter and spirit. In the very short run, we must focus on only two targets. First, we need to find additional revenue streams to stay on-budget as is desired by the IMF in its recent talks with local officials. Second, amidst dwindling reserves, the country need an injection of around $10 billion to avert the risks of default on its external obligations as we have to repay $8 billion in debt service including rollover of deposits in the remaining period of ongoing fiscal year. By June of this year, around $4.5 billion are expected to be fetched by China, Saudi Arabia, and the United Arab Emirates (UAE) as is proclaimed by the government officials. Another $1.1 loan tranche is expected if we got through the conditionalities of 9th review of the IMF programme. In the same way, after success with the IMF deal, other multilateral and bilateral lenders might opt to give loans to Pakistan. We can also float bonds in the international market if we could improve our international credit rating or could ensure our solvency. Moreover, declining discrepancy between inter-bank and open-market exchange rates might encourage remittances through official channels as has recently been observed with the removal of artificial cap on exchange rate which led to a depreciation of around 14.7 percent. To sum up, in order to avert the default risks, we need to resolve the deadlock with the IMF, reschedule our existing debt, seek more concessionary loans along with creating more revenue streams to stay on-budget.

Nevertheless, dodging the default through IMF bailout package or external debt is only a short-run cushion. Alternatively, we need medium-term and long-term reforms in order to put the economy on track of a sustainable growth and resolve our issues with regard to fiscal and current account deficits. To put it differently, we need investment, especially Foreign Direct Investment (FDI), which can raise our labor productivity and overall growth capacities. Likewise, we need exports which, along with upscaling our growth potentials, can cope with our external sector shortages. We have been an investment deficient country, with investment-to-GDP ratio remaining below 20 percent over the last four decades. In particular, private investment has remained around 10 percent of GDP which is roughly half of regional peers and only one-third of more dynamic emerging markets in Asia. Likewise, FDI has been averaged around 0.8 percent of GDP since 2010. A crucial feature of our current FDI is that 95 percent of it is driven by market-seeking motive, with negligible shares of those of the efficiency-seeking and natural resources based. This, in other words, suggests that we need to enhance our skills and productivity to augment efficiency-seeking and natural resources based FDI in Pakistan. Recently, the World Bank has estimated the untapped potential of FDI in Pakistan to be around $2.8 billion. To realize such potentials or enhance overall investment in the country, we need to ensure macroeconomic stability. In this regard, reforms that can guarantee external sector liquidity, maintain market-determined exchange rate, improve our sovereign credit rating, and mobilize domestic revenues are of upmost importance.

Likewise, market must be opened to global firms by providing them with level-playing field in terms of regulatory procedures, clearly-defined tax and trade policies, and investment-friendly infrastructure. Further, the leakages in State Owned Enterprises (SOEs) in terms of drain on aggregate productivity and burden on government fiscal space must be eliminated through reforms like corporate governance, market-based induction of CEOs, joint-ownership structure, and privatization of irremediable SOEs.

With regard to exports, we have been stagnant over the last two decades, with worsening competitiveness of our exports vis-à-vis our competitors. Pakistan's share in global trade dropped from 0.15 percent in 2005 to 0.12 percent in 2021 while, during the same period, Bangladesh's share in world exports increased from 0.06 percent to 0.19 percent, India's from 0.61 percent to 1.65 percent, and Vietnam's from 0.14 percent to 1.17 percent. Similarly, Pakistan's exports lack product diversification, with high concentration in resource-based items such as cotton, rice, hides and skins etc., dominated largely by textiles products and rice. With regard to market diversification, our main trading partners are only three, e.g. the United States, Europe, and China, though we sell much of our rice to the Middle East. Moreover, our firms struggle in terms of value-addition and in upscaling their sizes. All these obstacles call for structural reforms that can promote our exports; enlarge our product and market diversification; encourage value addition in exports; and enhance the scope of our exporters. The cost of doing business needs serious attention in this regard amidst tough competition from Bangladesh, India, and Vietnam. Internal security, productivity-oriented or growth-oriented incentives mechanism, rationalizing energy prices, and enabling regulatory environment should be the priority areas in order to reduce the costs of doing business in the country. As stated earlier, to encourage technological upgradation and enhance the size of businesses, we need to accommodate global firms, especially for joint-ventures. In addition, rationalizing tariff structure from the perspectives of anti-export bias and creating competition in the market might boost exports along with a thriving private sector.

Most of the reforms which are highlighted above are presumed to remove distortions only in the economic markets though their success largely depends on reforms in the political market. Alternatively, political will or reforms for removing distortions in the political market are central to the success of economic reforms. In particular, economic viability of the country needs to be the fundamental theme of political discourse. We need reforms in the political market that can enhance the accountability of our political elite, on one hand, and solve the problems of collective action and free riding with regard to unbridled subsidies, Statutory Regulatory Orders (SROs) and several other forms of regulatory abuse, on the other. Likewise, rationalization of public expenditure along with a transparent, fair and progressive tax system is essentially needed to bring down the fiscal deficit to limits. Specifically, the political elite must think like Mancur Olson's stationary bandit instead of roving bandit where its interests are more encompassing in pursuing growth-geared policies. They must focus on the share of wealth created by economic agents as taxes, as a revenue maximizing state would do, and that this option is more profitable to them than grabbing the extant wealth and fleeing.

The author is an Associate Professor at the Pakistan Institute of Development Economics (PIDE), Islamabad.