

Pakistan and Emerging Markets in the World Economy

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Good afternoon—Al salaamu’alaykum!

I would like to thank **Prime Minister Sharif** and **Minister Dar** for their warm invitation and State Bank **Governor Wathra** for hosting this event. This is my first visit to Pakistan and I am very pleased to be in Islamabad with all of you here today.

This is an important time—“a moment of opportunity”—for Pakistan, a country undergoing an economic transformation that can place it well among the ranks of emerging market economies.

Indeed, hard work and reforms are starting to pay off. Pakistan was recently upgraded from a frontier economy to an emerging market in the MSCI index. This is an important signal given a changing global landscape, especially for emerging and developing economies.

Over the past few years, economic dynamism in the world economy has gradually been shifting—from advanced economies to emerging markets. Today, these countries are home to 85 percent of the world’s population, and account for almost 60 percent of global GDP—up from just under half only a decade ago. While the global recovery has been subdued, emerging economies have contributed more than 80 percent of global growth since the crisis.

As dynamic as this group is, it is also diverse—geographically, culturally, and economically—and undergoing shifts and transitions that imply challenges, but also opportunities.

So where is Pakistan in this picture? Every year, more than two million young people enter the job market in this country. This could be a tremendous opportunity for growth. But it also presents challenges. How can you absorb so many new job seekers when the global economy is growing so slowly?

Clearly, in this environment, Pakistan needs to rely on the strength of its own policies to generate more growth and jobs, and to join the group of dynamic emerging markets.

- In thinking about how to meet these challenges, we can find guidance from Pakistan’s founder, Muhammad Ali Jinnah, who once said: “ *With faith, discipline, and selfless devotion to duty, there is nothing worthwhile you cannot achieve.* ”
- Today I would like to discuss how belief in the global system, discipline in economic reforms, and devotion to help one another can help Pakistan achieve sustainable prosperity.

1. Emerging Markets in the Global Economy

Let me start with an overview of the global outlook.

Overall, global growth has been too low, for too long, and in many countries has benefited too few people. Our forecasts for world growth are 3.1 percent this year and 3.4 percent next year—well below the 3.7 percent average for nearly two decades before the 2008 financial crisis. Underlying this picture is a complex set of factors.

In advanced economies, despite signs of recovery in some countries, overall growth prospects remain subdued. Many of them are still dealing with crisis legacies—high debt, low inflation, and low investment—but also higher uncertainty.

Low growth and uncertain prospects are feeding into populist and inward-looking attitudes. What we see today in many places is that belief in an open global system is being tested.

Yet, it is precisely this open economic architecture that has brought so many benefits to the world, especially for emerging and developing economies—including Pakistan. Over the years, we have seen child mortality go down, and life expectancy increase. Absolute poverty has declined, and school enrollment is on the rise. All this is evidence of a broader trend of economic convergence between poorer and richer nations.

Today, however, this convergence trend is slowing. The emerging market group will continue to grow—at 4.2 percent this year and 4.6 percent next year. The growth advantage over advanced economies is smaller than before. And as I said earlier, prospects differ.

China and India are growing at about 6-7 percent, while Brazil and Russia are showing signs of improvement after a period of severe contraction. Low commodity prices, especially oil, have hit commodity exporters hard, and in the Middle East, countries continue to struggle with ongoing conflicts and terrorism.

Emerging markets are also undergoing transitions of their own—shifts that create challenges but also opportunities. Let me mention two that are particularly relevant for Pakistan.

The first transition is in China. The world's second largest economy is rebalancing its economy—from manufacturing to services, from investment to consumption, and from exports to domestic services. This means a slower but more sustainable growth path.

This transition, however, is not without ripple effects—especially through trade. Think of it. China is now among the top ten trading partners for over 100 economies that account for about 80 percent of world GDP. It is also Pakistan's third largest trading partner—accounting for close to 20 percent of overall trade. So clearly, a slowing Chinese economy means fewer exports from Pakistan.

Yet there is also good news. As China moves up the value added chain, it will reduce its production of some labor-intensive goods. This is an opportunity for countries such as Pakistan, but Pakistan will need to retool its economy and train its people to realize this advantage.

Pakistan also stands to gain from the *second transition—the decline in oil and other commodity prices*. At the global level, the fall in oil prices created winners and losers.

Income was redistributed from heavy exporters such as Saudi Arabia and Russia to net importers such as Pakistan, India, and many others. In the case of Pakistan, a much lower oil import bill drove a marked improvement in your country's external balances and benefitted consumers and businesses.

Still, faced with such a drastic fall in prices and rising financial pressures, many of the commodity exporters had to adjust and growth slowed. This is the case for the GCC countries. As a result, the growth of remittances from GCC countries, which account for nearly two thirds of total such inflows to Pakistan, also slowed.

Taken together, the outlook for emerging and developing economies calls for guarded optimism. With subdued growth in advanced economies and shifts in China and commodity markets, emerging markets will have to rely more on internal sources of growth. This places a premium on strong policies and institutions that are capable of boosting productivity and generating sustainable and inclusive growth.

Indeed, putting in place strong policies to boost growth is an urgent task for *all* countries around the world. At the same time, we must also heed the concerns of those who have been left behind by change—be it technological or trade. Without an open global system, it will be very difficult for emerging and developing economies to continue to close the income gap with their advanced counterparts.

2. Pakistan: building a strong foundation to join the emerging markets

How is Pakistan positioned in this constellation of global factors? The good news is that Pakistan has already begun to strengthen its drivers of growth.

Just three years ago, the country was on the brink of an economic crisis. Today, and thanks to the authorities' homegrown program of reforms that the IMF supported, the economy is on a much stronger footing. Public finances have improved considerably, external reserve buffers have been rebuilt, and growth has been gradually strengthening. These are very encouraging developments.

Pakistan has also made important strides in growth-supporting policies. A clear example is the power sector. Not everything has been resolved, but disruptive power outages have come down—from about nine hours to one hour per day for industries, and from eight to five hours for urban consumers.

Costly and inefficient subsidies were reduced. These subsidies disproportionately benefited the more affluent. And the accumulation of power sector arrears, also known as circular debt, has also significantly decreased. These are major achievements.

There have been equally important achievements on the budget revenue side. By closing tax loopholes and setting up a more targeted approach to widen the tax base, revenue collection improved by 2 ½ percent of GDP over the past three years.

These tax reforms matter. Why? Because efforts to mobilize higher revenues have freed up resources to raise public investment and to strengthen social safety nets. For instance, more than 1½ million new beneficiaries were added to the Benazir Income Support Program, and the program's cash stipends were raised by more than 50 percent. This is an important step since 30 percent of the population still lives below the poverty line.

Having achieved such difficult reforms, the economy has come a long way. Now, with a more resilient economy and growth picking up, Pakistan has reached a moment of opportunity. It can now embark on the next generation of reforms to generate higher and more inclusive growth, and tap into the dynamism of emerging economies.

3. Pakistan: next generation reforms

Keeping in mind the discipline Mr. Jinnah emphasized, I see three priority areas for economic reforms.

First, reinforce Pakistan's economic resilience.

A challenging global environment means the economy needs to become even more resilient.

Despite the significant fiscal consolidation achieved under the program, public debt remains high, at about 19 trillion rupees, or 65 percent of GDP. This debt needs to be serviced and, at current levels, the interest bill is larger than Pakistan's entire development budget. To place debt on a downward trajectory, action is needed on both revenue and expenditures.

On the revenue side, despite the marked improvements over the IMF-supported program, Pakistan today still only collects little more than half of what is estimated as a feasible amount. This means continued efforts are needed to bring more people into the tax net and ensure that all pay their fair share.

At the same time, reducing public enterprise losses can enable a scaling up of growth-enhancing investment in physical and human capital. Currently, these losses amount to more than two thirds of what is spent on the Benazir Income Support Program. Imagine what you could do with that amount of extra resources!

Taken together, these reforms are important to reduce budget deficits and build sufficient buffers to protect the country against shocks that may come down the road. In parallel, there is a need to continue strengthening social safety nets to protect the most vulnerable segments of society. These steps will pave the path to higher growth, which brings me to my second priority.

Second, raise growth.

This can be done by promoting private investment, strengthening exports, and raising productivity. Private investment in Pakistan today accounts for only 10 percent of the economy. In emerging markets however, the average is about 18 percent. Pakistan's exports are about 10 percent of GDP; emerging markets' exports are nearly four times as high.

So here too, Pakistan can do better. Higher public investment in infrastructure can help. For instance, continuing support for projects under the China-Pakistan Economic Corridor will not only promote growth and job creation, but will also facilitate regional integration.

- Another way to boost growth is by improving the business climate—by strengthening governance and enabling the private sector to thrive. Pakistan ranks 117 out of 168 countries in perceived corruption.
- Although direct social and economic losses are difficult to measure, even a perception of corruption deters private investment and impedes efforts to promote sustainable and inclusive growth. Increasing transparency and accountability and removing red tape can help. For example, it still takes Pakistani companies much too long to figure out their tax forms. That time could be spent much more efficiently on pursuing business opportunities.
- Simplifying procedures to open new businesses, enforce contracts, and pay taxes can go a long way in promoting growth. At the same time, the energy sector reform needs to be completed.
- All in all, I see enormous upside potential. IMF studies show that improving Pakistan’s business environment to the average of, say, the Middle East and North Africa region could increase growth by 1½ percentage points per year.

Third, make growth more inclusive.

Or as *Mr. Jinnah* would say, “*devotion to one another*”.

Increasing access to education is crucial, especially in Pakistan where youth comprise about 60 percent of the population. IMF research suggests that improvements in education have contributed importantly to reducing income inequality within countries.

Currently, education outcomes in Pakistan remain weak. One out of every 12 children in the world that does not attend school lives in Pakistan. I am aware that access to education is a key concern for the Pakistani citizen, a point brought across when I met with Malala Yousafzai.

Bolstering public investment in education from 2½ percent of GDP to emerging market average—around 4 percent of GDP—will be essential to prepare the workforce with the necessary skills and make Pakistan more competitive on the global market.

Beyond education, there is also a need to improve women’s participation in the economy. Closing gender gaps in economic participation could boost GDP by up to a third. These gains are non-trivial. Women can be a game-changer for Pakistan!

4. Conclusion —Pakistan and the IMF: the partnership continues

Pakistan has made significant economic progress. There is still much to do, but I am confident that Pakistan will succeed.

You have shown that you are ready and prepared to tackle hard issues. The successful completion of the three-year IMF-supported program is clear evidence.

Although the program has ended, our partnership will continue. We have been a partner with Pakistan for over 65 years, and we will remain closely engaged through policy dialogue and capacity building programs, as you implement necessary reforms and strengthen your institutions.

Let me conclude. The Urdu poet, philosopher and politician, Sir Muhammad ‘Allama’ Iqbal, said: “ *Be aware of your own worth, use all of your power to achieve it. Create an ocean from a dewdrop. Do not beg for light from the moon, obtain it from the **spark** within you.*”

This is a moment of opportunity for Pakistan. The *spark* to continue transforming Pakistan’s economy into a dynamic, vibrant, and integrated emerging market that is able to create sustainable jobs and prosperity for all exists among Pakistan’s people and policymakers. We look forward to working with all of you to make it happen.