

Revival of the Economy: Obstacles and Strategies

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There is widespread despondency and pessimism in the country, especially due to the very difficult security and law and order situation in different parts of the country. Combined with growing political uncertainty and a very difficult economic outlook, many citizens are worried about the future of the country.

Let me therefore start with the positive side of the balance sheet:

- The revival of democracy, in March 2008, notwithstanding much dissatisfaction, is a very positive development which must be sustained.
- The restoration of superior Judiciary in March 2009, as a result of a very successful movement by the lawyers and the civil society marks the commencement of a new era of an independent Judiciary.
- The unanimous passage of the 18th Constitutional Amendment is one of the major accomplishments of the democratic process. This package of 100 amendments in 97 articles of the Constitution passed by consensus, not only restores the parliamentary character of the Constitution by strengthening the Parliament and the Provincial Assemblies but also enhances Provincial autonomy.
- The 7th NFC Award, notified in May 2010, was historic because for the first time the share of the provinces in the divisible pool became larger than the federal share and also because the provinces had agreed on a multiple criteria for the distribution of resources in modification of the previous population based criteria.
- The announcement of 30 point package for the rights of Balochistan in November 2009 and administrative and political reforms for Gilgit Baltistan of September 2009 are also important positive developments.
- The media in Pakistan is free and vibrant and is playing a major role in exposing corruption scandals and social evils in the society.

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- The civil society organizations have become very active and played a major role in assisting, along with Pakistan armed forces, the flood affected people struck by the worst floods in the country's history in July-August 2010.
- There is now a strong and growing national consensus about eliminating extremism and terrorism from the society. This consensus was a major factor in success of the military operations in Swat and South Waziristan in 2009. This provides a strong basis for evolving a national plan to combat terrorism.
- Pakistan managed to avoid a serious damage to its financial institutions during the global financial crisis of 2008-09, partly because the reforms of the banking sector in the 1990s had allowed, liberalization of exchange controls without allowing full capital account convertibility. Our banks had not therefore participated in the purchase of sub prime mortgages of American Banks.

Obstacles to growth

There is currently an interesting guessing game in the media, whether or not India will surpass China next year in terms of annual rate of growth, by achieving a GDP growth rate of 10 percent. China, as we all know, has maintained an unperented growth rate of over 10 percent in the past 30 years. India started late but in the past 10 years has managed to accelerate its growth rate to 7-8 percent per annum, but is now preparing for the first time in its history to achieve double digit growth in 2010-11.

In comparison, Pakistan, which was ahead of India for almost four decades between 1960 to 1995, with an average growth rate of 6 percent, while India during this period was growing only at 4 – 4.5 percent - the so-called “Hindu rate of growth”. But in the past 15 years, the average growth rate in Pakistan, despite the short-lived acceleration between 2004-2006, has declined to less than 4.5 percent on the average for the 15 years period of 1996–2010. It is important therefore to investigate the structural and other causes of this slow down in the rate of growth.

The most serious structural problem facing the Pakistan's economy is the secular decline in the investment/ GDP ratio from over 20 percent in the early 1990s to less than 16 percent in the past few years. This decline is largely due to the deteriorating security and law and order situation which has undermined investor's confidence in the economy and has probably encouraged capital flight. The investment climate has also been adversely affected by the prevailing political uncertainty and the reports about large scale corruption. The number of new companies listed in the Karachi stock market in the 10 year period from 2000 to

2010, for example, was only 80, compared to 200 companies in the three year period of 1990-93. In fact the number of listed companies on the Karachi stock market has declined from 762 in 1999-2000 to 650 in 2009-10.

The second significant structural problem is the continuous decline in the tax/GDP ratio from over 14 percent in the early 1990s to less than 10 percent in the past three years. At the same time, non-development expenditure has grown by 11 percent per annum or four fold from Rs. 626 billion in 1999-2000 to 2877 billion in 2009-2010. This gap between revenues and expenditures, supplemented by certain other factors like losses of public sector corporations and circular debt, has created a very serious fiscal imbalance in the economy.

The third factor responsible for slower growth is the unraveling of the power sector, as a result of the prolonged neglect of the required investment in the generation, transmission and distribution of electricity. The resultant load-shedding of electricity now aggravated by load-shedding of gas, has become a key constraint on capacity utilization, industrial growth and exports.

These structural obstacles to growth have been compounded by the stabilization policies reflected in high interest rates and a cut back in development expenditure. The resultant reduction in aggregate demand, combined with supply side bottlenecks, especially of power, water, and gas has adversely affected the industrial sector. Average growth in the manufacturing sector became negative (-3.7 percent) in 2008-09 and has barely recovered to less than 5 percent in 2009-10.

In addition, the unprecedented and devastating floods have caused a huge loss of output (3 percent of GDP), widespread damage to physical infrastructure and unbelievable human distress and dislocation. The cost of reconstruction alone could exceed \$ 10 billion. Meanwhile, the damage to crops, and infrastructure would continue to exert a downward pressure on the growth rate.

Strategies for economic revival

In the face of these multi-dimensional obstacles to growth, revival of the economy and the desired acceleration of annual growth rate to 6-7 percent, will not be possible without wide ranging reforms to address the structural problems such as quality of governance, shortage and high cost of energy, effectiveness of resource use, the chronic fiscal deficit, and widespread corruption.

In the *medium term*, i.e. the next 3 to 5 years, the revival of the economy can be pursued through three inter-related strategies:

- i) The process of globalization has changed the structure of production and trade in the world economy. There are a number of new opportunities that have opened for countries like Pakistan that are physically close to some of the more rapidly growing and dynamic economies of the world. Pakistan has a well developed agriculture sector which can become the engine of growth and also become a significant earner of foreign exchange provided we undertake a major programme of diversifying into *value added agriculture*.

While the overall investment climate may be clouded by terrorist activities, there is considerable potential for attracting foreign investment from the Middle East in agriculture and in agro processing of products like milk, meat, edible oil, fruits, and vegetables. This in turn will require stronger links between agricultural research and industry and investments in post harvest transport, storage and marketing in cold chains.

- ii) The second major opportunity for accelerated growth in the short run is in the *small scale industrial and commercial sectors*. Pakistan has 3.3 million economic establishments of which over 90 percent are small enterprises employing less than 5 workers and another 4 percent are medium sized enterprises employing between 6 and 50 workers. Most of these establishments survive on skills that were developed in the sub-continent over centuries in sub-sectors like sports goods, furniture and light engineering. Many of these sectors have great potential for growth and exports, if they are supported through credit, technical support in meeting W.T.O. standards and export houses that can sub-contract export orders to several firms and then facilitate packaging and shipping. There are many possibilities of creating partnerships with interested firms in countries like China, Korea and Turkey in these sub-sectors.
- iii) The spurt in the prices of cotton and cotton products in the current year will create opportunities for expanding and modernizing the *value added sectors in textiles* if incentives like a liberal depreciation allowance are provided for balancing and modernization. Expanding income in rural areas as a result of higher commodity prices will also generate demand for many industrial products and assist in the revival of the economy.

Developing a longer term growth strategy

Pakistan needs a sustained annual growth rate of 8 percent to deal effectively with the explosive problem of unemployment in the country. A strategy that can propel Pakistan into such a high trajectory of growth will have to include the following main elements:

- A very significant improvement in the quality of governance across the board but especially in relation to public sector enterprises. At present only three corporations namely: PIA, Pak Steel and Railways have accumulated losses of Rs. 200 billion and Pepco has an accumulated debt of Rs. 425 billion. Unless these corporations are restructured and managed strictly on merit and sound business principles, the fiscal imbalances will persist.
- Major investments in the energy sector to add affordable supplies of electricity and gas to all industrial and commercial consumers, and reducing losses in the transmission and distribution of electricity.
- A quantum jump in expenditures on research, innovation and development of human resources by the Federal and the Provincial Governments. Currently, Pakistan ranks at number 79 out of 132 countries on the Global Innovation Index, compared to 24, 26 and 30 for Malaysia, China and India.
- A determined effort, in consultation with all stakeholders, to improve the security environment in the Region. The economic cost of terrorism exceeds \$8 billion a year and seems to be rising if lost opportunities are taken into account.
- Reducing the cost of doing business in Pakistan is also an important pre-requisite. In the World Bank's "Indicators of cost of doing business", Pakistan ranks 77th out of 181 countries. The report describes a number of areas where Pakistan has to intensify efforts and modify policies and institutions. These would include arrangements for enforcement of contracts, tackling technological backwardness, arrangements for health insurance and pension of private employees and lowering the cost of capital and energy.

These pre-requisites may appear formidable and somewhat unrealistic, but many other countries have shown that with determined and visionary leadership, such ambitious goals, vital for the future of the country, can be achieved in a short period of time.