Consolidating gains of macroeconomic stability

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By M. Sharif

Political government's biggest challenge is to exploit the gains of macroeconomic stability achieved during the past three years at much cost to the middle class for sustainable higher economic growth which should ultimately benefit the masses. The latter point is at least equally important as is achieving sustainable higher growth rate. What options does the government have? It is one of the most crucial questions being debated presently. Divergent views exist on the subject.

The government's economic policies are merely an extension of the previous military-led government because of the political constraints in which the present political set-up is to operate. Yet, as the dynamics of any economy demonstrates, there is change in the external and internal economic factors in the country which if exploited with economic acumen should help achieving higher economic growth rate of 6-7 per cent within next 2-3 years. Such a growth rate is essential to achieve to address multi-faceted economic and social problems faced by the people and government.

Macroeconomic stability

Statistics of a number of macroeconomic indicators related to the first five months of current fiscal years are the best guide to ascertain better side of macro-economic stability. Tax revenue, exports and FDI, stocks and forex reserves are the indicators which count quite a lot in ascertaining macro-economic stability.

Tax revenue collection is one of the sour points. The previous government succeeded to raise tax revenue collection from around PKR 300 billion in 1999 to about PKR 400 billion in 2002. An average increase of 33 per cent, which was no mean achievement, particularly during the period when the economy was recessed. But, it fell short, each year from the target that was fixed in the budget. The revenue target under went not one time, but at least 2 to 3 times revision. Current fiscal year's target is PKR 457.8 billion has been revised downward from PKR 460 billion against PKR 404 billion collected during the last fiscal year. Tax revenue collection during July — November period stood at PKR 156.7 billion against a target of PKR 156.6 billion, an increase of 0.06 per cent. It is something positive against PKR 135.56 billion collected during the first five months of last fiscal year, tax revenue collection so far is 15 per cent higher. In case the current trend of hitting the monthly and half-yearly targets were met, the possibility of hitting the annual target — perhaps for the first time after past many years will be a quite a positive achievement. Nevertheless it would be short by about PKR 140 billion from the ideal tax-to-GDP ratio of 20 per cent of GDP, which should fetch more than PKR 600 billion. Will it be possible to hit the annual target? One must keep optimism alive even against a few odd ground realities which might raise their head during the remaining period of the fiscal year.

Thrilled by the 16 per cent increase in exports earning during past five months of current fiscal year over the earnings of corresponding period of last fiscal year, a wave of optimism has over taken the scepticism of, the past three years on the grounds that double digit exports earning might become a reality. In case it happened, for which the possibility cannot be ruled out, it would be breaking stagnated exports of $8 to 9 billion over past a few years. It is to be appreciated that 16 per cent increase has been recorded against many odds such as falling value of US dollar against rupee, fall in unit price of exported commodities, textiles and garments. The fall in prices in cotton, textile and garments is because of prevailing recession in the US, Europe and Japan — our main export markets. Increase in exports is a positive sign because WB and some of analysts have pleaded export — led economic growth as the most suitable and viable option for Pakistan. Can the trend be sustained with accelerated impetus? It must happen so because this is the need of economy and of the country. Pakistan needs to register at least 10 per cent increase in its exports earnings during next five years.

... the dynamics of any economy demonstrates the change in the external and internal economic factors in the country which if exploited with acumen should help achieving higher economic growth rate. Higher growth rate is essential to address multi-faceted economic and social problems faced by the people and government

Growth and exports are unlikely to show a positive trend without increase in domestic and foreign investment. This has been the weakest area during the past three years. During the last fiscal year, domestic investment was PKR 30 billion against a target of around PKR 96 billion. Similarly FDI was $446 million against a target of $600 million. This year's target for domestic investment is PKR 96.7 billion and for FDI, it is $1.0 billion. FDI increased to $462.1 million during July — November period against $161.6 million during the corresponding period of the last financial year. The increase is 186 per cent.

The major areas which have attracted FDI are; financial business, chemical, oil and gas, transport, trade and textile — in the same order of priority. Major FDI investors are UAE (37.3 per cent), UK (21.8 per cent), USA (22.6 per cent) and Saudi Arabia (4 per cent). The present trend is likely to persist and might get further impetus depending upon the policies to be pursued by the new government. There are indications that the government is serious to create environment for attracting investment. Without increase in domestic and foreign investment, growth and exports might not pick-up up to the desired level.

KSE 100-share index crossed the 2600 points barrier. It was nine-year high. It has added around PKR 150 billion to the market captionalisation that has soared to PKR 564 billion which is less by PKR 46 billion from the high market, capitalisation of PKR 610 billion achieved in March 1995 when KSE 100-share index hit 2662 point. PKR 150 billion increase in market capitalisation indicates that market is showing confidence in investment. Excess liquidity is making investment attractive. Forex reserves have crossed $9.5 billion. It is yet another positive macro-economic indicator to bang on.

The other side of macro-economic stability

There are always two sides of a picture. In case macro-economic indicators highlighted in preceding paragraphs show positive side of economy, the other of the economy there, where macro-economic indicators look 'passive spectators'. They also count a lot to assess overall economic performance of the outgoing government. A number of indicators such as increase in unemployment (8.7 per cent according to a conservative estimate), 20 per cent increase in cost of utilities over last three years, shrinking income level particularly of poor, lower and middle classes, low economic growth, high subsidy for banks, KESC and WAPDA, high fiscal deficit (7 per cent during last year) and low PSDP expenditure i.e., 3.1 per cent of GDP, around 7 per cent increase in the poverty level in the country during past three years despite loud claims of the government to alleviate poverty with WB/IMF financial assistance, raise a number of questions about the efficacy of exclusive macro-economic stability economic policy. The cry for benefiting from gains in current account, high forex reserve and stable currency, excess liquidity available with the banks is not without genuine reason and concern. The question is about: how to benefit? What are the options for the government?

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Debate about options

There is a general consensus among financial analysts, executives and economists that despite gains in macro-economic indicators, people in general have suffered mostly on account of all those factors which represent 'the other side' of the macro-economic stability. There is also consensus that further economic squeeze is least desirable. In fact the time to provide relief to the people has come. The government is also itching for it as her declaration and decisions to decrease power tariff by PRs0.12 paisa per unit for all consumers reduction in the price of essential drugs and the promise to lower the price of gas and oil indicates. It is imperative that the relief measures should be backed by a high and sustainable economic growth rate and its benefits should trickle down to the grass-root level. Without this, relief measures will be isolated acts which would negatively affect fragile macro-economic stability. So far the government has not come forward with a comprehensive road map to give impetus to economic growth by exploiting the gains made by the previous government.

Investment, increase in PSDP, 'pro-poor' growth strategy, reducing subsidy for white elephants of economy like WAPDA and KESC and the Chinese-model or export-led growth model are being hyped as the essentials to break the vicious cycle of economic stagnation in the country. The other essentials are good economic governance, efficient functioning of CBR and effective micro level poverty alleviation programmes.

Economy needs substantial amount of domestic as well as foreign investment in manufacturing, SMEs and value-addition to give boost to exports. The existing investment rate of around 12 per cent, is too low to give impetus to higher economic growth rate. The parameters for private investment such as de-regulation of petroleum and energy sectors, lower import tariff, market based interest rate, excess liquidity available with commercial banks, stable rupee and rupee-dollar parity, monetary stability and taxation reforms, are favourable for attracting investment. But, in an economy like ours, where private investment is yet to take roots to establish itself as main vehicle of growth, it looks upto public sector investment for re-assurance. PSDP that presently stands at 3.1 per cent of GDP needs to be increased to around 5-6 per cent of GDP in next 4-5 years along with substantial increase in social spending. This will certainly encourage high private domestic and foreign investment.

The government during 90s and past three years has been reducing public expenditure out of sheer necessity of reducing fiscal deficit to around 3 to 3.5 per cent of GDP which she never achieved to oblige IMF. She must review such a policy because higher revenue can be generated only through higher growth rate. The fiscal deficit bottom-line fixed by IMF is extremely difficult to achieve and subsequently adhere to. Even EU member states who have joined the Euro-zone are finding extremely difficult to adhere to a similar standard. A higher fiscal deficit of around 5 per cent should be acceptable to IMF for Pakistan. India is following it whose overall fiscal deficit inclusive of fiscal deficit by the provincial states is much higher.

Whereas parametres for private investment have improved, the need to create environment to facilitate investment and to win investor's confidence such as effective 'one window' operation, prompt availability of services and utilities and good governance at micro-level are yet to show up. It is one of the sour points of domestic and foreign investors that deters them to invest.

Private — public partnership to boost investment has been pleaded as one of the viable options by some of the analysts and economists. It might not work well in our environment for various reasons. In any such partnership, the private side of the partnership will be seriously handicapped to move upward because of drag of public partnership. The two are likely to form an unequal and imbalanced partnership for economic revival. One must, therefore, look upto separate roles and areas of operations for the private as well as public investment.

Stepping into the Chinese model

Despite the green patches of macro-economic stability, the economy suffers from serious infrastructural imbalances that impede desired level of economic growth. Some of the grey areas of economy include high cost of utilities particularly such as gas, electricity and transportation. They have to be cheap to reduce the production cost of products and commodities for domestic and foreign markets, subsidies being provided to power sector (WAPDA and KESC) and nationalised banks, a debateable monetary policy being pursued by the SBP, which analysts observe is not sustainable, neglect of SMEs and agriculture sectors and lack of pro-poor economic policies which are creating serious distortions among different strata of society. In case the economy is to serve the people, it must attain GDP growth rate of around 6-7 per cent within next 2-3 years. This will not come through unless infrastructural inadequacies were addressed, human resource development was given top priority and investment was made in a big way in sectors such as agriculture, manufacturing value-addition and SMEs, which have appetite for it.

The Chinese model based on massive production of garments, electronic and other utility items in export free zones exclusively for exports is being advocated for Pakistan by some of the analysts and WB officials. The government has been advised by WB specialists to adopt export-led growth policy for economic turnaround and seek foreign investment in dynamic and productive sectors rather than pursuing mega-infrastructure products. She should also get the economy ready for the next round of trade and industrial expansion through export led growth because export sector grows faster than the real economy.

Pre-requisites for fruitfully benefiting from the Chinese model are skillful and knowledgeable cheap human resource capable of producing high-tech utility items, availability of cheap power and other infrastructure at door steps, one-window operation for investors, totally de-regulated forex rules and regulations and labour laws within EPZs which favour investors. Pakistan is 1000 miles behind China to pursue her model. Nevertheless, if the export-led model is pursued diligently and with commitment, it can put Pakistan on the map along with those Southeast Asian countries which have performed economic miracle. Exports-led growth over past one and a half-a-decade has also made the economy of Greater China i.e. mainland China, Hong Kong and Taiwan, the largest world economy with $7.8 trillion GDP after EU ($9.3 trillion) and the US ($10.4 trillion). It is estimated that after 5 years from now, Greater China economy will be the second largest economy of the world with $12.4 trillion GDP after the US with $13.7 trillion GDP. It will be poised to bridge the gap and overtake the US economy. As a first step, Pakistan must strive to establish one or two EPZs successfully and its exports should outstrip imports.

Conclusion

Macro-economic stability, domestic and external economic factors have created environment for exponential growth of investment provided bureaucratic bottlenecks were addressed to facilitate investment. Equally important to attract investment is to address infrastructural and human resource inadequacies that exist at present. Export-led growth model is a tested one as proved by the Asian tiger economies and by Greater China. But, the model will be successful in Pakistan only if its pre-requisites including the change in mindset of investors, government functionaries, mid-level executives and labour were met on priority. Can the government, which is now to accomplish the task of achieving higher economic growth, meet the challenge? It should otherwise fragile macro-economic stability will lose its lustre.