

Maintaining high growth rates

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Pak-Eco
Down 18/4/05

THE country's economic managers are in an upbeat mood predicting a stronger GDP growth than the target because of a better growth in agricultural output owing to timely rains and the impressive rate of increase in industrial output. They have every reason to be pleased with themselves.

There is indeed good news all round on the economic front. GDP growth is on course to exceed six per cent, foreign exchange reserves have crossed \$ 12.6 billion, inflation and interest rates are at their lowest in recent memory and the stock market has not only surged to unprecedented levels, it is also maintaining itself at such dizzy heights.

Even though a significant contribution to industrial progress has been made by sub-sectors in which Pakistan does not have a comparative advantage (for instance, automobiles, electronics, sugar, etc.), nevertheless development in these sectors is pushing up demand for goods and services, fuelling overall growth. Based on these facts, should we make forecasts about the future by extrapolating the growth rates of the recent past? Can the growth in industrial output sustain itself on this elevated path? And is there an economic rationale for being optimistic about the country's future economic prospects?

To begin with, let us note that the much improved growth rate, especially of the manufacturing sector, is essentially because of the decline in interest rates. The fall in interest rates has boosted growth by stimulating both consumption and investment. This raises the question whether we should be underpinning our

demand for scarce skills that will keep them within the country, thereby benefiting the economy. If the pace of domestic activity picks up further, it could even attract the return of those who had emigrated and settled abroad.

Moreover, an extremely weak human capital base for the overwhelming majority of rural workers is the major impediment in a switch-over to non-agricultural jobs. To date the private returns to basic education have either remained low or are accruing over a longer timeframe compared with the time horizon of those living at near subsistence levels. This has kept the social demand for education (even for functional literacy) suppressed, as reflected in the weak participation and enrolment rates at all levels of education.

However, the growing opportunities from higher growth rates could eventually raise the

Moreover, the contribution of economic and political institutions (in the shape of a stable polity, reasonable rule of law and protection of property rights) that play an important role in influencing long-term growth rates, in view of their poor state, continues to be lower than their potential.

The institutions critical for matters of governance established by the state for developing markets (rule of law and protection of property rights), regulating markets (to address issues of market failure), ensuring stability of markets (the State Bank and SECP for regulating financial markets) and creating legitimacy (through democracy, a free media, social safety nets for the disadvantaged groups) have been weakened over time (with the honourable exceptions of the State Bank and the media), as reflected in the deteriorating law and order conditions, the growth

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in pending cases in courts, political instability owing to the continuing role of the military in running the country, heightened corruption and the politicization of the judiciary and the bureaucracy.

However, new developments are diluting the negative aspects of these features. These include the perceptible improvement in transparency in decision-making and government procedures and the greater vibrance and vigilance of the media (as a result of the increase in both the quantity and quality of it), which has subjected the government and representative institutions to greater public scrutiny.

Although the accountability of public functionaries may not have improved in tandem with the increase in transparency, the gap is narrowing, the presence and intrusiveness of NAB notwithstanding.

returns from education, thereby pushing up the demand for education (especially that facilitating the acquisition of technology based skills) on a more enduring basis.

The policy on deregulation and liberalization has also weakened

raises the question whether we should be underpinning our strategy for a more durable higher growth path on lower interest rates, considering this is one of the more vulnerable economic parameters, dependent on a variety of factors, both internal and external.

Sustainable growth requires that it be anchored in productivity gains. Although it may be too early to assess what is happening to productivity, it appears that so far the contribution of total factor productivity to per capita growth has not been high. Much of the increase in output has come from improved utilization of previously installed capacities.

A high level of human capital is an important prerequisite for a meaningful exploitation of modern technology. Not only is the lack of an adequately skilled manpower a key constraint to sustain high levels of industrial growth, our efforts to create such a force continue to be half-hearted. The continuing neglect of education and the migration abroad of the bulk of the limited stock of high quality human capital developed in the country have placed limits on the rates of growth.

It remains to be seen if the events of September 11 have reduced overseas demand for Pakistani skills and increasing opportunities within the country as a result of higher growth rates are creating an adequate

basis.

The growth of a sector creates a demand for the inputs required by the sector, thereby increasing incomes and demand for goods and services provided by the rest of the economy. Although the formal industrial sector contributes a relatively small share of total domestic product, it can play an important role in lifting the rest of the economy through its forward and backward linkages with the informal sector (both buy and sell goods and services to each other).

The externalities of development of the informal sector's managerial and organizational skills, combined with the spill-over benefits of new skills in service sectors like finance and telecommunications, making an overall contribution that is more significant than would be expected based on the size of the sector and its direct contribution to the GDP.

However, despite the decline in the contribution of agriculture to GDP to below 25 per cent, its role, owing to the nature and strength of forward and backward linkages, continues to be critical for the expansion of industrial output and thereby for the overall performance of the economy. And today the size of agricultural output is as much a gamble on the weather and monsoons as it was at the beginning of the 20th century.

The policy on deregulation and liberalization has also weakened the degree of adverse impact of corruption and political patronage, although the pace of privatization agenda now looks to be much too ambitious for the supporting institutions or productive capability of the economy, taking into consideration the social and income distribution impacts.

This is demonstrated by the recent elections in India. The poor performance, if not irrelevance, of the regulatory authorities in balancing the interests of investors (in terms of fair returns and a stable environment) and consumers (in terms of prices and quality of service) raises doubts about the fate of consumers after the privatization of Wapda, KESC and PTCL. The utter failure of the PTA in performing its regulatory functions with respect to the pricing and quality of service provided by mobile phone companies and of Nepra in regulating electricity tariffs (with the government and the multilateral lending agencies in fact dictating tariff levels) amply illustrate the point.

Finally, the feel-good factor will be instrumental in stimulating investor sentiment to sustain the current growth rates, a subject that needs to be discussed separately.

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