# New economic ideas

BY AQDAS AFZAL 2020-10-27
THE secret behind the spectacular success of economists in policymaking lies in the innovative nature of economic ideas.

Whenever ground realities have changed, economics has been able to offer an answer.

During the Great Depression, John Maynard Keynes made a powerful case for fiscal measures for kick-starting stagnated economies. Later, as developed countries faced stagflation stagnation and inflation Milton Friedman promoted monetary policy and central bank independence. The Covid-19 pandemic has had a devastating effect on economies and workers in Pakistan. To restart inclusive economic growth, Pakistani policymakers will have to borrow a leaf out of the policy innovation playbook.

Economic policy innovation is now on full display in the developed world. Though they have been leery of opening the fiscal tap in the past, developed nations have channelled massive fiscal stimulus into their economies.

The Economist notes that this year developed nations have announced $4.2 trillion in fiscal stimulus over 10 per cent of their combined GDP. Many policymakers in the developed world now envision a more significant and permanent role for fiscal policy in future macroeconomic management.

Covid-19 is an unprecedented economic catastrophe for developing countries, where economic contraction has reversed all the progress against poverty reduction in the last 23 years. The World Bank`s downside scenario estimates that Covid-19 will push between 49.3 million and 56.5m people into poverty in South Asia. Though World Bank did not provide country-wise numbers, Dr Hafiz Pasha and Shahid Kardar estimated that 15m to 20m Pakistanis could slip into poverty due to Covid-19. The alarmingly high magnitude of these poverty numbers should have spurred Pakistani policymakers into action as poverty is not only intrinsically unpleasant, but such a huge magnitude also foretells massive, unrelenting and devastating social unrest.

Strangely, economic policy innovation is conspicuously absent in Pakistan. The government claimed to have injected a fiscal stimulus of Rs1.24tr into the economy. Even when this amount paled in comparison with other countries, a full 45pc of this fiscal stimulus remained unused. Instead, the government has relied on the State Bank of Pakistan for injecting liquidity through an expansionary monetary policy. In short, the government has embraced standard mainstream economic policy by using monetary measures as a substitute for the desperately needed fiscal activism.

There are three main issues with the government`s approach.First, the government is still focused on fiscal consolidation, meaning that the government wants to curtail expenditure so that the fiscal deficit can be lowered.

Against the backdrop of the massive increase in poverty, the focus on fiscal consolidation is misplaced. Governments should only focus on alleviating economic misery during crises.

Second, research out of Columbia University shows that monetary levers like interest policy alone are not enough for maintaining macroeconomic stability. The preceding point raises a question mark about this government`s choice of monetary policy despite its ineffectiveness even in business-as-usualscenarios.

Finally, evidence from the State Bank itself shows that monetary measures have largely failed in stimulating demand.

Despite the sound and fury, total credit to private sector is actually down by 0.6pc in August this year compared to July 2019.

Simply, overwhelmed by the pandemic, banks do not deem businesses creditworthy,while businesses are reluctant to borrow given their fear about not being able to service debt.

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It is now becoming painfully obvious that standard thinking will not bring about economic recovery in Pakistan. Policyma-1(ers will have to go beyond just managing deficits and ratios to designing and implementing effective policies. Modern Monetary Theory (MMT), a heterodox approach, offers one way out of this impasse.

Stephanie Kelton, one of the leading proponents of MMT, argues in The Deficit Myth that countries that can print their own currencies, like Pakistan, should ignore debt-toGDP ratios and use their central banks to support public debt, thereby ensuring high employment. In other words, rather than relegating the central bank, MMT sees central banks as enablers for fiscal stimulus.

Pakistan is staring into the abyss of poverty-fuelled social unrest. Policymakers` thinl(ing and response can only be described as tepid, thus far. Economic thinking is changing everywhere in response to the Covid-19 pandemic. Pakistani policymakers must follow this trend and design new economic policies in order to save millions of Pakistanis from sliding into poverty.•   The writer is a Fulbright Scholar and has a doctorate. He teaches economics and public policy at Habib University, Karachi.

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