On the verge of take off?

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Pak Eco Dawn July

IS the Pakistan economy waking up from its long slumber and, to mix metaphors, is it on the verge of a take off? Could Pakistan now start to catch up with other economies of South Asia that have been doing so much better in terms of GDP growth?

There are three reasons why I am optimistic about the country's economic future and two further reasons why I would temper my enthusiasm with some caution. Let us first look at the positive side. At a press conference on June 5, a couple of days before he presented his budget for the 2003-2004 financial year, Finance Minister Shaukat Aziz provided preliminary data for the year ending June 30. Most numbers point towards a broad-based recovery from the economic slump that hit the country through most of the 'nineties.

The rate of GDP growth for 2002-2003 is projected at 5.1 per cent, half a per centage point more than that estimated only a month or so ago. The fact that the rate of GDP increase this year accelerated over that of last year by as much as 50 per cent — from 3.4 to 5.1 per cent — is certainly a cause for celebration. Economic expansion in 2002-03 was the fifth highest in Asia, behind that of China (eight per cent), Korea (6.1 per cent), Iran (six per cent) and Thailand (5.2 per cent) — which implies that at least in 2002-2003, Pakistan joined the league of high-performing beyond domestic demand. It also has surpluses in wheat and sugarcane.

However, it is not in Pakistan's long-term interest to use its enormous agricultural potential to produce two major crops — wheat and sugarcane — in which the country does not enjoy any comparative advantage.

Also these two crops are heavily subsidized by America and Europe. The country and its farmers would do well to diversify agriculture in favour of such high-value added products as fruits, vegetable and flowers. Moving towards the production of these commodities would bring much larger income to the farmers and earn the country additional foreign exchange.

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space" that can be put to use to achieve the two goals Islamabad appears to be aiming at: poverty redressal and development of physical infrastructure. This space was not created by the reordering of expenditure priorities — something that will need to be done in the future — but by reducing the burden of servicing domestic as well as external debts. Two policy initiatives resulted in a sharp reduction in the amount of budgetary resources expended on debt service.

The decision to side with America in that country's war against international terrorism led to the cancellation of one billion dollars of debt owed to Washington and of rescheduling of some other bilateral obligations.

Second, a sharp reduction in interest rates brought about a significant decline in the resources committed to servicing domestic debt. These moves contributed to reducing fiscal deficit by 0.6 per centage points, from 5.2 per cent of GDP to 4.6 per cent. If in 2003-04, fiscal deficit remains at the same level, the decline in the resources needed to service external and domestic debt will make an additional three per cent of GDP available for expenditure to the government. How should this amount be spent?

This brings us to the question asked earlier about Pakistan's sustainable rate of growth and how quickly the country could get back to it. Today, Pakistan has what I would describe as "suppressed growth" — growth that is available to the economic system that could be released by sound economic policies, a supthe league of high-performing Asian economies.

Are conditions now in place for this growth to be accelerated further? I believe that there still remains a gap between the current rate of growth and Pakistan's structural growth rate.

For that gap to be closed the country must maintain the policy momentum that produced this year's impressive performance. What is Pakistan's structural growth rate and how could it be achieved are some of the questions that I will address a little later in this column.

With the population increasing at 2.5 per cent, a 5.1 per cent increase in GDP translates into a growth in per capita income of 2.6 per cent a year. We know from the experience not only of Pakistan but also of other parts of the world that an economy has to grow at twice the rate of increase in population to begin to reduce the incidence of poverty.

This means that for the first time in more than a decade, Pakistan may have brought about a reduction in the number of people living in absolute poverty. The rate of economic growth will need to pick up by another two per centage points before a palpable dent can be made in the incidence of poverty.

Nonetheless, the revival of growth in 2002-03 must have brought some relief to the country's poor, whose numbers have been increasing by a troubling rate of 10 per cent a year, or nearly four times the increase in population.

Economic recovery seems to have touched most parts of the economy. Agriculture remains the backbone of the economy in terms of the proportion of the workforce it employs and the contribution it makes to the export sector. It saw an increase in output by 4.2 per cent over the year before.

The bulk of this increase came from three major crops — wheat, rice, sugarcane. Of these, rice production increased the most, by 15.4 per cent, from 3.9 million tons in 2001-02 to 4.5 million tons this year. Sugarcane output increased by 8.3 per cent, from 48 million tons to 52 million tons. Output of wheat increased by 4.4 per cent, from 18.2 million tons to 19 million tons. There was, however, a small decline in the output of cotton.

That agriculture remains so heavily dependent on four major crops is not necessarily a good thing. Pakistan has always been producing large surpluses of cotton. It is in fact, the second largest cotton exporter in the world after the United States. Similarly, output of rice is much similar pattern. Overall, the sector performed impressively with the value of its output in 2002-03 increasing by almost twice as much as in the previous year, by 8.7 per cent compared to last year's 4.9 per cent.

A significant part of this increase came from an explosion in the production of the automobile sector with output increasing by almost 50 per cent. This industry is flourishing for two reasons: increase in the disposable incomes of the upper classes, which in turn points to some further deterioration in income distribution, and protection available to it against imports.

This does not mean that a vibrant automobile sector is not good for the economy. The incentive structure for the industry should be such as to make it competitive with the rest of the world.

Meeting sharp increases in domestic demand by protecting the industry is not sound economics. The budget of 2003-04 took a step in the right direction by significantly reducing import duties on some automobiles.

Some other parts of the manufacturing sector that performed well during the year included machinery and metal with an output increasing by 18.4 per cent; tires and tubes with production growing by 16.2 per cent; and paper and board with an output increase of 15.7 per cent. However, two of the more important components of the sector — food processing and textiles - did less well than the average. The output of the former increased by 8.5 per cent and that of the latter by only 5.2 per cent. There were reasons why these industries did relatively poorly. Food processing is made up mostly of small businesses that don't have easy access to capital, are not familiar with new technologies, and are still dependent on antiquated supply chains.

A great deal needs to be done to improve the infrastructure that supports the food processing industry and to have the financial sector — banks as well as the capital markets — become familiar with the financing needs of the businesses operating in the industry. The relatively poor performance of the textile and apparel industries was due to the sluggish international demand for their products. These industries are the ones most deeply affected by both booms and busts in the global economy. A sluggish global economy is taking its toll on this sector.

It is encouraging that the revival in broad-based growth in the economy was accompanied by the creation of "fiscal ... describe as "suppressed growth" — growth that is available to the economic system that could be released by sound economic policies, a supporting political environment at home, and an external situation that does not produce any more shocks for the country. My estimate of the amount of growth that remains bottled up in the system is equivalent to 35 per cent of the gross domestic product.

If this could be released over a period of a decade, it could add another three percentage points of growth to GDP, bringing the increase to between seven and eight per cent a year. A seven per cent growth rate sustained over ten years would double the gross domestic product from $68 billion estimated for 2003, to $135 billion ten years from now. Pakistan's population by 2013 is likely to increase to 180 million. Even then, its income per head in that year could reach $750, some 56 per cent more than at present. This then is the potential that is there waiting to be exploited.

To get to that potential will need greater public sector investment in physical in infrastructure and human resource development. It will also need a greater display of confidence on the part of the private sector which, in turn, should manifest itself in more resources committed by it to the economy's productive sector. A beginning in these directions may have been made in the budget announced by Minister Aziz on June 7. He indicated a fairly sharp increase in the public sector development programme from $2.1 billion to $2.8 billion, an increase of one-third.

In terms of the share of GDP going into this activity, this is equivalent to more than four per cent, an increase of one per centage point. This is still short of the proportion that was being spent in the 1960s, so far the golden era of Pakistan's economic history. But a beginning has been made to revive public sector development expenditure.

I like the emphasis on housing in the budget, a sector that could help revive a number of small enterprises associated with the building industry. This should also help increase urban employment and put more money into the pockets of the poor.

The three reasons why we could be hopeful about Pakistan's economic future include the resumption of broad-based growth, increase in public sector expenditure and focus on at least one sector that could increase employment for the semi-skilled and unskilled components of the workforce. But what are the two pitfalls the economy still faces? I will answer this question next week.