Institute for Policy Reforms

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Sustained economic growth not possible without structural reforms

Economic growth rate picked up modestly in 2015-16. However, there was no visible effort to address structural issues faced by the economy. This is stated in the annual review of the economy 2015-16 released today by the Institute for Policy Reforms. The report recognizes that some economic indicators improved. These include the fiscal deficit, inflation, and the current account deficit. For the first time in many years, Government achieved and exceeded its FBR tax collection target, which grew by 20%. Current expenditure remained within budget. Low markup rates increased demand for private credit.

However, the economy's future prospects depend on much needed policy changes. There are fundamental issues that prevent the economy to achieve sustained economic growth. Economic growth must be based on two pillars: improved long term fundamentals, and higher level of productivity. Whereas some fundamentals have improved, the economy suffers from vulnerabilities.

Public debt has increased rapidly with some external financing procured at high cost. The report states that Pakistan's external sector is weak. Exports fell in 2015-16, FDI is low despite inflows from China, and workers' remittance is presently in modest growth. However, it could drop or slow down by the effects of energy prices on Middle Eastern economies. Quoting IMF, the report states that in the next four years, current account deficit will remain between minus 1.8% to minus 2.3% of GDP and FDI will remain modest. Annual external financing needs will grow from USD 7.3 Billion in 2015-16 to USD 14.4 Billion in 2019-20. Short term debt is expected to grow steeply from 4.2% to 8% of GDP.

Higher productivity, the second growth pillar, comes from better infrastructure, upgraded skills, R&D, and improvement in governance to reduce transaction cost. So far we have not seen a major policy initiative to empower economic players and improve governance. Governments, federal and provincial, have yet to launch a meaningful programme to invest in the people.

The productive sector of the economy remains sluggish. Production of major crops fell by 6.25%. IPR fears that there may be structural issues at play here. Policy makers have done little to address water availability and its efficient use. In fact, federal allocation for the water sector has declined in the last two years. Industry grew by 3.21%. It is encouraging to see private sector credit increase by 105%. Half of the additional credit has gone into fixed investment, though the share of manufacturing in new private investment has declined. The economy is still constrained by power shortage and though new investment will increase generation capacity, there is no policy shift to make the total power supply chain efficient.

Similarly, savings and investment remain below the economy’s need to grow. Government is expected to make negative savings for the foreseeable future. While development expenditure, including CPEC, has increased from the previous year, questions remain about project selection, transparent procurement, and effective project management. These issues reduce the returns to the economy from PSDP spending.

To support growth, policy makers must review the political economy. It shows most obviously in the structure of public finance both in revenue collection, but equally in expenditure priorities. Delay in addressing this issue leads to high government debt and does not allow sufficient public investment. The economy needs an urgent and effective response to the constraining structural issues.