Institute for Policy Reforms

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Pakistan exports are in free fall

For the last two years, Pakistan's "exports have been in free fall". This is stated in a review of the economy for the first quarter 2016-17 issued today by the Institute for Policy Reforms. Exports declined in a broad range of sectors. The report calls for a proactive and concerted effort to arrest the trend. This is critical to improve long term fundamentals of the economy and to reduce Pakistan's external vulnerability. The report further reminds that higher imports to improve power supply and for servicing of external debt have increased the economy's forex needs. Exports declined 8% in 2014-15, a further 12.5% in 2015-16, and again by 9% in the quarter under review. During the quarter, imports grew by 10% and the fiscal deficit expanded by 29%. In a troubling development, the report fears that after years of growth, overseas remittance may have begun to decline. Though it is yet early to confirm this.

Agriculture production has improved after last year's dismal performance. Production of cotton grew by 18%. It fell by 30% last year. Other major crops have recovered. However, against the target growth rate of 5.9% for 2016-17, year-on year LSM grew by 2.3% for the first quarter. Production declined in a number of major industries including textiles. During the quarter, the amount of private credit decreased compared to last year.

First quarter results show worsening of both fiscal and current account deficits. Fiscal deficit was 1.3% of GDP for the quarter against a target of 3.8% for the year. Current account deficit was 1.1%, while the year's target is 1.5% of GDP.

FBR tax collection and federal government revenue grew by 4% and 3% respectively. This is on top of the unprecedented increase of 20% during 2016-17. On the other hand, expenditures have remained within proportionate budget. In fact, development spending is lower than the first quarter last year.

The report states that quick fixes will not help with the growing twin deficits and signs of medium term external vulnerability. They require structural reforms through major policy changes. Without much needed reforms, the economy will continue to perform within a band of low to moderate growth. Public debt will continue to rise as revenues stay well behind needs. Export growth too will remain uncertain. Our exports must reduce dependence on textiles and apparels and, more importantly, change the strategy from competing on price to product differentiation. The economy's fundamentals remain uncertain and there is no indication of increase in productivity. In a period of low markup in the country, GoP has increased short-term debt while reducing long-term borrowing.

Of the factors that increase productivity, infrastructure will improve in coming years, largely from CPEC. However, there is need for urgent action to upgrade skills, improve R&D as well as governance. Reducing the social deficit will provide better workers for the factory floors, in offices, and better entrepreneurs. By not doing so, Pakistan has missed out on a large part of its potential. It will also reduce poverty in the country.

Savings and investment remain modest. Last year, their ratio to GDP were well below target level. While targets for the current fiscal year too are the same, there is no new policy in place to achieve them. Government must lead a concerted effort to reduce its negative savings. Also, last year, private investment fell from 10.2% of GDP in 2014-15 to 9.8% in 2015-16.

Sustained growth will depend on improved performance of commodity producing sector, agriculture and industry. Within this, power supply and manufacturing are of special importance. Growth of 4% in year on year power supply is lower than GDP growth rate. However, this is likely to improve soon.

Import of power generation machinery has increased greatly. In 2015-16, Pakistan imported power generation machinery worth USD 1.8 Billion. Since then, the country has imported an additional USD 795 Million worth of machinery imported during the first quarter. Pakistan is expected to approach target of increasing power generation by about 13,000 MW by 2018 to 2020, including 10,700 MW under CPEC. Figures for import of other machinery show overall revival in industry. These imports are apparently financed by debt as FDI is still low. However, for sustained growth, the economy will need more than just machinery imports.

Development expenditure remains encumbered in the deeper issues of project selection, transparent procurement, and effective project management. Improvement is needed in these areas to maximize returns to the economy. Also, public investment is well below needs.

It is critical also that government reviews the political economy. This is most obvious in both tax policy as well as in expenditure preferences. Present policies have led to high public debt and inadequate resources for public investment. Overall, the economy needs an urgent and effective response to the constraining structural issues.