Institute for Policy Reforms

Press Release, 10 April 2017

Economic environment restricts growth in Pakistan.

Pakistan's weak economic indicators are a consequence of policy making that deal with symptoms and not fundamental issues. This is stated in the six-month economic review issued today by the Institute for Policy Reforms.

The report says that sudden rise in the current account deficit is serious. "At 2.6% of GDP it has breached already the year's target of 1.5% of GDP." Pakistan's exports as a ratio of GDP are at a historic low. This ratio was in double digits in 2000-10. It is now about 5%. Pakistan has had higher current account deficits before. But they were financed by grant aid or FDI. In other cases, we had to go for IMF arrangements.

Having just ended an IMF programme, it is unclear what choice the country has now. Part of the external debt also finances current expenditure. Government is borrowing to service debt. SBP has imposed a condition of 100% cash margin on consumer goods import. We could see more restraints. This is happening during low energy prices.

The economy's vulnerability will continue. At 2.4% of GDP in December 2016, fiscal deficit will exceed government's target of 3.8% of GDP. Also, from now on, SBP and government must keep an eye on increase in inflation, though it is still under control.

The viability of the external sector depends on exports and workers' remittance. These have been falling. The fall in exports is because of low competitiveness and lack of manufacturing depth. We have yet to see serious analysis or a strategy in response. More significantly, there is no thought given to job growth for the two million young Pakistanis entering the job market each year. Economic development results from political choice and leadership's commitment to growth.

Investment is essential for economic growth. Recently, our investment has hovered around 15% of GDP. By comparison, in 2015, China, India, and Vietnam invested 46%, 32%, and 28% of GDP respectively. The growth rate of these economies that year was 6.9%, 7.6%, and 6.7% respectively. The additional amount needed to raise Pakistan's total investment to the minimum desired level of 20% of GDP, is Rs.1.7 Trillion or about USD 16 Billion annually. This must come from increase in national savings and higher FDI. Incurring further debt, even if available, is unsustainable. However, FDI in 2016-17 may be short of government's target by about USD 2 Billion.

The report recognizes encouraging signs in the economy. With low discount rate, private credit has grown. Equally, import of machinery and of POL products are signs of revival. An improving security situation, CPEC investments, and increase in development spending should strengthen investor confidence. However, rising current account and fiscal deficits will dampen revival. This may force SBP to increase the discount rate. Similarly, the effect of increase in import on BoP is uncertain.

Power supply grew by 4% during the half year. This is below last year’s GDP growth of 4.7%. For reliable power, increase in generation capacity is not enough. Circular debt has grown despite low oil prices. It will continue to grow until government does not improve DISCOs revenue. Otherwise, increase in generation capacity will only increase circular debt. The same is true for PSEs. Subsidy for them will continue as they have neither been reformed nor privatized.

Public projects seem to have progressed well during the half year, with release of 60% of funds for the year. However, progress was uneven across sectors. Release of funds was high in LNG power generation, highways, Railways, and PAEC. It was slow in other key sectors including the critical water sector, health, and higher education. These are all necessary for growth. Releases do not mean that money has been spent. Compared to the Rs. 482.7 Billion released, the amount booked by Finance Ministry for the half year is Rs. 198 Billion.

Public investment is important to increase economic productivity and to crowd in private investment. IPR is concerned at some of government’s priorities, which has reduced budget for higher education and health. The water sector is one third lower than its budget for 2014-15.

Federal government debt has increased. Though increase is lower than last year, it has enhanced GoP’s burden. Total increase in public and private external debt and liabilities was over USD 1 Billion for the half year.