The Future Direction of Pakistan's economy[1]

A road map for action

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Pakistan has once again achieved Macroeconomic stability under the constrained actions precipitated by the agreement with the Fund and supported by the friendly donors. The past episodes of achieving stability have proved to be short lived once the accelerator is applied to speed up the growth rate ,Consequently,the pains caused by the difficulties faced during the period of stabilization do not get translated into the gains of sustainable and inclusive growth. Everyone realizes that Growth is pivotal for reducing poverty, improving the living standards of the middle class, providing jobs to the new entrants to the labor force, buoyancy of tax revenues, lowering the burden of debt and so on.

By now, the diagnostics for this transition failure are quite well known. Our savings are low and thus investment is below the warranted rate needed to maintain the target growth rate . Aggregate Demand expansion , whenever growth resumes, therefore spills over to imported goods as domestic productive capacity is inadequate .Foreign Exchange earnings in form of Exports of goods and services , Remittances and Foreign Direct Investment do not suffice to meet the obligations of External debt servicing, Imports of Goods and Services and Repatriation of dividends, profits etc. Domestic Resource mobilization is so weak that it can hardly finance interest payments and Defence expenditures . Energy costs have made our industry non competitive while unaffordable for households.

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Institutions for delivery of basic goods and services to the public at large are dysfunctional and inefficient.

Actions to overcome these gaps, deficits, weaknesses are also quite well known. To recapitulate for the sake of completeness the road map should consist of short term, medium term and long term actions which are summarized below.

SHORT TERM

a. The 18th amendment to the Constitution and the 7th National Finance Commission have very rightly devolved administrative, legal, and financial powers and authority from the federal to the provincial governments. However, this devolution has remained incomplete so far. The provinces had not transferred powers and resources further down to local governments, where most of the interaction between an ordinary citizen and the government takes place. The 2019 Punjab Local Government Act which was later substituted by a compromised 2021 Act was designed to substantially devolve these powers to the grass root level empowering the communities to make decisions about their development and welfare of their citizens. As Pakistan is rapidly urbanizing the administration and management of metropolitan areas, cities and towns were to be entrusted to autonomous, directly elected Metropolitan, Municipal Corporations and Town councils . These bodies were assigned responsibilities along with financial resources and ability to mobilize taxes, fees, user charges, cesses for provision of services and development in their respective jurisdictions. Directly elected Mayors and the councils, as they would be accountable for results, were expected to deliver public goods and services to the common citizens more effectively, efficiently and economically compared to the present highly centralized system.

b. The present efforts to widen the tax base and document the economy are facing stiff resistance. In the past these efforts could not bear fruits because of protests, strikes and political pressures. Restructuring of the federal Board of Revenue (FBR) and provincial revenue collecting authorities, simplification of tax codes, increased use of electronic data bases talking to each other, digital invoicing and QR codes, minimal contact between tax payers and tax collectors by digitalization and AI , risk based audit, bringing new tax payers in the tax base and full accounting of declared income, gradually reducing withholding taxes and more transparent valuation methods for assessing import duties and sales tax, reduction of import tariffs, mobilization of urban property tax and agriculture income tax are some of the measures that would correct some of the distortions , minimize leakages and corruption and maximize revenue collection. These measures would help the country in lowering the Public Debt ratio to 60 percent as stipulated in Fiscal Limitation Act and thus lower the burden of Interest payments. Increased Tax GDP Ratio would reduce the Overall fiscal deficit.

c. On the expenditure side, across the board subsidies for food, electricity, gas , fertilizers etc should be substituted by targeted subsidies through Benazir Income Support Program using the National Socio Economic Registry Data. Provincial Development projects should be transferred from the Federal to the Provincial budgets. State owned enterprises SOEs are incurring huge losses as they have been captured by their workers, managers ,bureaucratic supervisors and political masters. Whenever any Government wishes to take some tough measures it is immediately confronted by strikes, shut downs and suspension of transport causing immense hardships to the daily life of common citizens. The government backs down and the status quo ante is restored. By restructuring or privatizing these enterprises not only losses would be curbed helping improve the fiscal situation and increasing spending on Human Capital formation but improved efficiency gains would contribute towards higher growth. It is not realized that the privatization of nationalized commercial banks and the Pakistan Telecom has resulted in huge gains for the budget in form of corporate profits, dividends etc. The residual value of Government equity showed a remarkable upswing instead of continuous injection for recapitalization of banks. Pakistani banks today enjoy high capital adequacy ratios and low non-performing loans. Telecom liberalization has significantly reduced user charges and provided mobile phone services to 180 million people and access to internet to 90 million people by auctioning spectrum for 3G and 4G. As the SOE Act and SOE Policy are in place the Government should accelerate the program whereby SOEs would either be restructured, sold to strategic investors, merged or liquidated as the case may be. The fiscal space created by the above savings and increased revenues should be able to raise Public Investment -GDP ratio to 5 percent thus contributing to higher Investment GDP ratio.

d. The administrative machinery of the civil services as a whole has almost reached at the verge of a break down.

Therefore, design of reforms in the police, civil services, organizational structure of the Federal and Provincial Governments and public utilities are already in place and all that is required is the political consensus and drive to implement them. The Committee on Right sizing the Federal Government should also be replicated in the provincial governments which have expanded in size and expenditures without consequential improvement in provision of Education, Health, Drinking water, Sanitation etc. The capacity of civil servants to remain neutral and objective, which used to be their hallmark, has to be rebuilt and their morale and motivation revitalized so that they are able to regain their lost space in the country's governance structure and processes. Equality of opportunity, transparent and merit based selection, promotion and career progression, performance measured on the basis of key performance indicators, continuous learning and training, as well as compensation based on performance and weeding out of those who are falling behind the curve are necessary but difficult reforms that could eventually upgrade the quality of civil services at all tiers of the government.

e. Management and Regulatory practices in the government need to be modernized and overhauled. Over centralization and the concentration of power, overly long hierarchical chains, multiple consultations for the sake of form and procedure rather than substance, turf building and turf protection, and the tendency to pass the buck have created a big gap between promises and performance. Public Financial Management Law approved by the Parliament has made a beginning by delegating financial powers from the Ministry of

Finance to line Ministries. The rules of business have to be rewritten to assign clear responsibilities to ministries, giving them the requisite authority to fulfill their obligations and holding them accountable for results. Inter-ministerial coordination and conflict resolution is beginning to take place at the level of the secretaries' committees. Regulatory guillotine ought to be applied to axe outdated laws, rules, regulations and processes. E government tools under implementation would help ensure transparency and the expeditious pursuit of business and coordination efforts. The combination of reduced tax burden on organized formal sector along with easing the burden of regulatory overdrive and lowering the foot print of Government in Rent thick sectors, promoting competition in energy sector , and strengthening Debt and Equity capital markets and financial inclusion would provide a big push to Private Investment GDP ratio of around 20 percent.

MEDIUM TERM

f. Poor educational standards, low literacy levels, large numbers of out of school children, rote learning and memorization, outdated and irrelevant curriculum offerings have made our educational system non responsive to the economic and social needs of the country. Limited access to schooling particularly post primary in the backward districts while the well to do families send their children to the best private schools have widened inequalities. The Government should facilitate talented students from poor families to get undergraduate education at reputed Universities and Colleges throughout the country. There is huge demand both within the country and outside for technical manpower but we are producing unemployable school and college graduates without any skills. A major program to promote technical & vocational training, make higher education more relevant, reorient scientific research towards national problems has to be given priority. Start-ups and entrepreneurship programs have been set up in a few major cities but have to be expanded throughout the country in a phased manner. Human capital is the basic factor that would determine whether a country is able to participate in Knowledge economy and technological revolution of the 21st century. STEM education right from the primary schools all the way to the Universities has to be promoted for inculcating inquisitiveness, creativity and innovational thinking.

g. In the financial sector, access to capital remains restricted to a very small minority while the majority of the farmers, firms, self-employed, employees and households who make large contribution to the country's income are unable to obtain financing from formal institutions as they do not have the collateral and security to offer..Micro finance had opened up the vista for the poor but is facing serious problems since COVID 19 and the coverage has stalled. National Financial Inclusion Strategy through Digital financial services is an attempt to broaden the base and provide access to the SMEs , women entrepreneurs , Small and medium farmers, low cost housing and consumer finance. . Digital banks should use Data analytics to predict the behavior of potential borrowers, and construct credit scoring models that would enable financial institutions to make credit decisions at low acquisition cost and also mitigate the risk of default. Algorithms are now available to guide the credit decisions and the banks in Pakistan should adopt this methodology to expand their outreach to underserved sectors and underprivileged individuals and firms. Private Equity and Venture Capital Funds, takafuls , insurance, pension and endowment funds can be source of mobilizing domestic savings and channeling funds to private investors. Capital Debt market should be developed so that large credit worthy companies can meet their demand for expansion and new investment not through banks but capital market.

h. The vast difference in yields in crops and livestock between small and progressive large farmers can be bridged to raise the overall production by focusing on Small and medium farmers. As they do not have any tangible assets—skills or capital—they have no other option but to be dependent on their landlords, arhthis or money lenders –all of them part of the elite class. They are thus trapped in low productivity equilibrium depriving the country of the surpluses expected from such a large contiguous irrigated area. Imports of food and commodities of $ 10 billion a year can be eliminated by combining technical advice, financing, buy back guarantees, efficient water use , certified seeds , fertilizers, pesticides, equipment leasing . Warehousing, Cold storages, Farm to market roads, refrigerated vans, agri malls will help reduce waste and enhance returns to this category of farmers . Contract farming by business houses has proved successful in case of Maize, Potato, Chilies , Milk and should be extended to other crops and livestock products. Fruits and Vegetables, Fisheries and Marine products, Meat and Dairy products are attractive items for export markets particularly in the neighboring regions.

i. There are some “rent thick” Sectors such as real estate, construction, railways, ports, airports, highways, media and telecommunications, mining, oil and gas , food procurement in which the Government enjoys disproportionate powers in determining the financial health of a company through administered prices , award of contracts, concession agreements, spectrum allocations and grant of licenses, tariff determination, permits. These sectors have to be made more transparent and exposed to competition. For example, in power sector the new Renewable Energy Policy has introduced open competitive bidding for tariff determination instead of upfront cost plus, guaranteed rates of return, capacity payments. The IPP policies prevalent since 1994 have made our exports noncompetitive and prohibitive for our households. Circular Debt amounting to Rs. 2.4 trillion in addition to trillions of rupees paid out of budget as subsidies is a direct outcome of these flawed policies. Multiple buyers and multiple sellers with retail and marketing opened up to the private sector with the Transmission company only recovering wheeling charges can enter into contracts without any interference by the Government. Guaranteed rates of return on equity, should be dispensed with. Gas companies ought to be split into generation, transmission, distribution companies and market competition introduced by licencing private sector companies . The present flawed model of price setting that relies upon a cost plus methodology with a guaranteed rate of return allowing uncounted for gas losses is simply not viable.

Weighted average cost of Gas is pending for past several years to be implemented.

j. Pakistan's exports have performed dismally compared to its neighbors. Export-GDP ratio has declined to 10 percent – one of the lowest in the developing world. The composition of export goods basket has remained almost unchanged since 1990s and low tech, resource based items dominate this basket. In addition to product concentration the destination is limited to a few select markets such as EU and the US while penetration in other dynamic markets is negligible. The Government 's efforts should be limited to promoting competitiveness in mid tech and sun rise industrial products and services. Artificial crutches to support the sun set industries be gradually taken away as market determined exchange rate, realistic interest rate and low tariffs on raw materials and components are the appropriate instruments to guide allocation of resources. The present system of energy pricing, delays in refunds ,excessive taxation of industry and exports , high tariffs for protecting domestic industry have to dispensed with. Textile industry is unable to take advantage of Man made fibre mix because of tariff protection. Similarly, participation in Global Value chain is stymied because of tariff restrictions. The initiatives such as National Single Window, Faceless Custom Clearnce, FASTER, Export Facilitation scheme are welcome steps and ought to be expanded to other operations of FBR and other Government agencies such as standards, quality assurance, testing . Performance Incentives that are time bound be given for new exportable products and for new export markets. Logistic costs to reach Ports including Gwadar Port should be comparable to those prevailing in other competitor countries. The government's support should be focused on research and development and commercialization of new products and Export-Import Bank facilitating exporters to penetrate new markets. Joint ventures with foreign companies that link Pakistani exports to global supply chain, bring in technology and marketing along with FDI should also be given incentives for limited period of time. Export of IT services are making headway and it must be ensured that they are given free hand to capture market share.

k. Although the Government should not choose the winners but indicate the priority sectors in which the private businesses should invest under a policy consistent, predicable and enabling environment. The criteria that would guide the selection of priority sectors ought to be (i) Export Manufacturing industries and information technology oriented services, (ii) Maximum employment generation – Direct and indirect, (iii) Transfer of technology. Using these criteria, the sectors and sub sectors that would make sense are Intermediate industrial goods such as Steel, Petrochemicals, Aluminum, Chemicals and Pharmaceuticals; productivity enhancement in cotton, wheat, oil seeds; efficient utilization of irrigation water through lining of water courses and drip/sprinkler irrigation ; modernization of agricultural marketing and value addition processing ; Small and Medium enterprises; Low Cost Housing, Tourism and Information Technology. Oil and Gas Exploration companies particularly the foreign companies should be offered remunerative pricing, a facilitative regulatory environment and choice to sell to non government buyers. This along with modernization of refineries would bring significant import savings. Nine Special Economic

Zones that are to be established under CPEC for attracting Chinese and other foreign investors to locate their industries have faced a lot of problems that need to be fixed expeditiously to make them operational. .

l. The Commission on Science and Technology and various Commissions on Information Technology should bring in all S & T Organizations under one Umbrella and encourage collaboration and integration in the value chain including multi-disciplinary research. Research and Development Investment in Agriculture , Industry, Energy , Climate change, should be incentivized by offering competitive grants to researchers and scientists rather than bearing fixed costs of salaries and allowances , pensions and rents which consume 95 percent of the budget leaving almost nothing for actual experimentation and application . Pakistan Atomic Energy Commission and organizations working under Strategic Plan Division provide good models for the civilian scientists to emulate. . Private sector investment in R&D should be given tax credits.

LONG TERM

The long term agenda would be driven by Climate change ,Technological Disruption, Demographics and jobs for the youth. The picture is hazy at present as it is evolving rapidly and our response has to be tailored accordingly. As these challenges all involve “ whole of the Country ” approach in which all the Ministries, agencies, departments, universities, scientific institutes, private sector , philanthropic organizations, and civil society all have to work together the present mechanisms of coordination and collaboration have to be revisited and new innovative solutions found. Existing job are likely to disappear and new jobs with different skill set would be created. The possible impact of AI is still being debated. However, one thing that requires attention is that the advanced countries with the ageing population would require young skilled workers from countries such as Pakistan. We have to start upskilling, reskilling our new entrants to labour force in response to the requirements of the host countries. A concerted effort by all segments of the society is needed and it is encouraging to see welfare and philanthropic organizations stepping up in this field and training the young men and women in large numbers in these skills. Government has to act as the guide for shepherding this process that is dynamic and rapidly changing.

Finally, it must be stated categorically that in a private sector driven economy the role of the judiciary in economic transactions is extremely critical. The dispensation of justice in Pakistan has become time consuming, expensive, convoluted, and unnecessarily layered. State revenues and bank loans, amounting to hundreds of billions of rupees, are held up due to litigation. Property titles and exchanges of deed have lost their sanctity because of prolonged disputes and complex processes prescribed by courts. Markets are based on sanctity of Private property and contracts. A judicial system that is unable to ensure protection and security of property rights of an individual and firm would inadvertently generate an ethos where the mighty and powerful are able to enforce these contracts on their own terms through extra legal means. After favourable verdict is announced it still takes years to get decrees granted by the courts executed.

To conclude, as macroeconomic stability is achieved the long and arduous pathway towards resumption of socially inclusive economic growth and job creation should be traversed. For that to happen, the State, markets and civil society have to work together in harmony and unison showing perseverance and tolerating tough structural reforms. We have to move up the development trajectories that open up opportunities and build up capabilities for the majority of the population –away from the present trajectory that benefits a minority i.e. the elites of this society.